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THE CANADIAN CHARTERED ACCOUNTANT

THE CANADIAN INSTITUTE OF CHARTERED ACCOUNTANTS

Capital Gains Re-Examined

A Budget for Saskatchewan Road Transport

The Case for Social Accounting

Taxes and Canada's Economic Troubles

ACCOUNTING RESEARCH • THE TAX REVIEW • CURRENT READING
ADMINISTRATIVE ACCOUNTING • STUDENTS DEPARTMENT

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The President takes a second look

"As I see it, then—" the President began ticking points off on his fingers "—the customer's credit rating is in a low bracket. Under the terms of our policy with American Credit Insurance, this gives us a relatively low coverage. This, in turn, doesn't warrant our shipping the order. Is that right?"

"That's right, sir". The Credit Manager sounded almost apologetic. "You see, in the policy, a schedule of ratings and coverages is automatically established."

"Then why," the Sales Manager demanded, "do we have credit insurance at all?"

"Accounts Receivable," said the Treasurer, "represent our second largest asset. We want to protect it. Credit Insurance keeps our loss ratio low."

"But," the Sales Manager said, "we lose the order, I say we ought to take a chance!"

"It's not a chance, it's a gamble," said the Treasurer.

"That settles it," the President said with regret. "We can't take the chance. We'll have to lose the order."

Ten minutes later the Credit Manager was apologetic again, but with a difference this time. "Sir, I want to ask you now to reconsider the decision on that account! I decided to take a second look at our policy. Then I called our American Credit Insurance agent and confirmed it. The account can be covered for more under our policy. All we do is obtain an endorsement, approving the account by name. After they investigate it, of course. All I need now—" the Credit Manager paused for breath "—is approval to pass the credit when the endorsement is obtained!"

"You – decided – to – take – a – second—" the President spaced out his words, then suddenly chuckled. "Well, I guess I can take a second look too! You've got the approval!"

* * *

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IN THIS ISSUE

RALPH LOFFMARK, C.A.

Even though the taxation of "capital gains" has received considerable publicity in recent years, the subject is one that continues to be of special interest and, at times, heated controversy. In his article "Capital Gains Re-examined", Ralph Loffmark reviews some of the statutory provisions and the judicial concept of income and cites a number of interesting cases showing the difficulties encountered in distinguishing non-recurring gains as either income or capital transactions.

Mr. Loffmark is an assistant professor of the School of Commerce at the University of British Columbia. He was admitted to the Bar in 1951 and shortly thereafter obtained an M.B.A. degree from the University of Pennsylvania. He received his certificate in chartered accountancy in 1955 after four years with Helliwell, Maclachlan & Co. of Vancouver.

FRANK COPITHORNE, C.A.

Is it practicable to develop a flexible operating budget for a service industry? Some say this is not feasible, but Frank Copithorne, in his article "A Budget for Saskatchewan Road Transportation", describes the system which has been adopted in Saskatchewan with, he claims, considerable success. He concludes that to look on a budget principally as a means of cost reduction is to ignore its points of greatest usefulness, namely that of helping to make staff more aware of the values of planning and control.

Mr. Copithorne is general manager of the Saskatchewan Transportation Company. He is a member of the Cabinet Advisory Committee on Natural Gas and Chairman of the Saskatchewan Industrial Development Fund Committee. He was previously comptroller of the Saskatchewan Power Corporation, following an eight year association as general auditor and later control manager with the British Columbia Electric Company Limited and its subsidiaries in Vancouver.

J. E. SMYTH, C.A.

The development of national income statistics has been proceeding almost without notice by many practising accountants; yet the measurement of income (at least for businesses) is the special concern of accountants. In his article "The Case for Social Accounting" Mr. Smyth attempts to compare the measurement of national income with the measurement of business income and notes the points of similarity and difference adherent in the approach of each of these tasks. He also makes a case for greater interest on the part of practising accountants in this branch of accounting.

Now associate professor of Commerce at the School of Commerce and Administration, Mr. Smyth has been associated with Queen's University, Kingston, for the past ten years. He has wide experience in the university's accountancy training program and is editor of the Students' Department of *The Canadian Chartered Accountant*. He is the author of several publications, including "The Basis of

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Accounting", and co-author of a new book recently published "Corporation Finance in Canada".

BR. CLEMENT LOCKQUELL, F.S.C.

Brother Clement Lockquell was prompted to ask the question can chartered accountancy truly claim to be a liberal profession because close study of the functions of the administrator revealed to him complexities and human problems far beyond his original assessment. To function efficiently, the administrator must be able to appraise the very real and pressing problems which arise almost daily, says the author of our French language article. He must move from an overall picture to a particuular situation and back again and keep himself adjusted to the change in perspective. He must not expect the order and logic which exist in abstract reasoning to be similarly present in the solving of concrete problems. The administrator's rise up the executive ladder will be conditioned by his ability to alternate between the reality of ideas and reality itself. The successful business man must know with which one he is dealing.

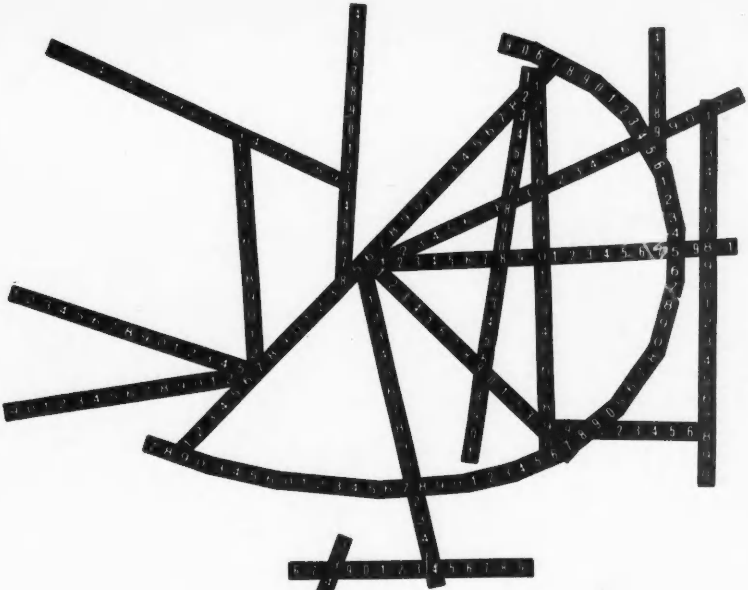
Brother Lockquell in addition to being Assistant Professor of French Contemporary Philosophy and Professor of Differential Philosophy at Laval University in Quebec City is also Dean of the Faculty of Commerce. He is the author of the novel "Les Elus que vous Etes" which won him the Literary Award of the Province of Quebec.

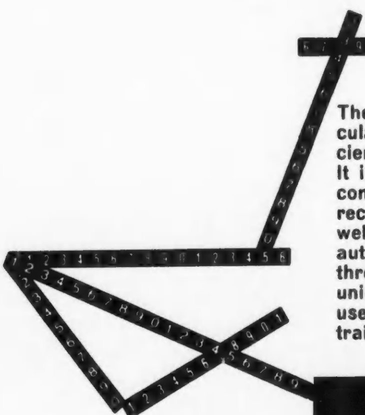
FORTHCOMING FEATURES

The Accountant's Professional Liability.

Business Interruption Claims.

An Approach to Church Accounting.





NOTES AND COMMENTS

Protesting Taxpayers Often Win Appeals

Of every five taxpayers who put down a $15 deposit to file an appeal before the Income Tax Appeal Board, two had their money refunded when they were successful in their appeals, according to a review of 1955 tax cases by CCH Canadian Limited, a publisher of Canadian tax reports.

The ITAB lists 225 appeals heard during the year, with the taxpayer's winning in 63 cases. In another 19, they managed to get a judgment which was partially in their favour. Almost 50 appeals were allowed by the Minister of National Revenue before they came up for hearing by the Board.

CPAs Approve Dropping Date of Retained Earnings

Ten years should usually be long enough for a corporation to date its retained earnings, or earned surplus, following a quasi-reorganization, according to a recent bulletin issued by the Accounting Procedure Committee of the American Institute of Accountants.

This situation generally occurs when a corporation has eliminated its accumulated deficit by a change in its capital structure (for example, by reducing its paid-in capital or the par value of its stock) without undergoing a formal reorganization.

Necessities of Life Require Less Income

North Americans today spend less of their available income to provide the essentials and comforts of daily life than they did 20 years ago, said Dr. N. H. Engle of the Bureau of Business Research, University of Washington, in an address to the Society of Industrial and Cost Accountants of British Columbia.

In 1935 the typical American (or Canadian) family spent 78% of disposable personal income on food, housing, furniture, clothing, medical care, transportation, etc. Today the typical family is able to purchase a substantially higher standard of living with 61% of disposable personal income. "As people have their basic wants satisfied, it becomes increasingly difficult to sell to them," he said. He foresaw a marketing revolution in which research would be used to determine the wants of people and production would be guided in the right direction to answer those wants.

A Step Towards Uniformity

A sub-committee of the C.I.C.A. Committee on Cooperation with Other Accounting Bodies met representatives of the Society of Industrial and Cost Accountants on March 3 with a view to developing a uniform course in the earlier years of instruction. Members of this sub-committee representing the Canadian Institute

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are Kris Mapp, D. Fraser Wilson and Charles Mackechnie, all of Toronto.

Annual Conference Coordinators

At a meeting on February 27 of the Annual Conference Program Committee, three members were appointed to coordinate the technical program under the chairmanship of Campbell Leach. S. E. V. Smith, partner of Price Waterhouse & Co, Toronto, will be responsible for the sessions designed to appeal to accountants in practice and G. H. Ward will take care of those directed to the small practitioner. Features aimed at interesting the industrial accountant will be handled by Harry C. Cox, comptroller of Distillers Corp. Ltd.

In Aid of Students

To assist students in the preparation for and writing of examinations, the Committee on Education and Examinations will publish a brochure in June on the background and technique of examination writing. Topics will include setting of papers by the Board of Examiners-in-Chief, proper methods of studying under the C.A. course, procedures for the final pre-examination review, suggestions for tackling a paper once it confronts the candidate, common weaknesses and deficiencies in candidates' answers, and meanings of standard examination terms.

Board Meeting

On April 12, 13 and 14 the Board of Examiners-in-Chief will meet at Mont Gabriel, Quebec, to prepare the drafts of the 1956 examinations.

In the News

GUY E. HOULT, C.A., senior partner of P. S. Ross & Sons, has been appointed financial adviser to the Fowler Royal Commission on Radio and Television Broadcasting. The main work of the Commission is to examine the financial needs of the CBC and to recommend to the government ways of meeting these needs.

New president of the Public Accountants Council for the Province of Ontario is J. G. BROWN, F.C.A. Other chartered accountants elected to the Council are W. J. Ayers, secretary, D. A. Ampleford, C. K. MacGillivray, Hamish Macdonald, W. L. McDonald, W. G. B. Read, and Guy Smith.

R. B. DALE-HARRIS, a partner of McDonald, Currie & Company was recently elected president, the Toronto Branch of the Canadian Red Cross Society.

Federal-Provincial Tax Negotiations

The Canadian Tax Foundation is continuing the policy of keeping its members informed on tax matters by the recent publication of an interim report on Federal-Provincial tax negotiations. The commentary deals with the Government's reasons for launching a discussion on this subject some months before any meetings need have been held, and it outlines and appraises the new proposals. This is an important subject for the outcome of the negotiations will vitally affect the welfare of every citizen.

Practical Office Automation

A 3 day meeting and equipment exhibition on the new approach to office mechanisation, sponsored by the Toronto Chapters of NOMA and the Systems and Procedures Association, will take place at the Royal York Hotel, Toronto, on April 17, 18 and 19. The speaker at the dinner meeting on April 18 will be Gordon E. Bower of Moore Business Forms who will discuss Practical Office Automation. Further information may be obtained from V. R. Frazier, London & Lancashire Insurance Company Ltd., 61 Adelaide Street East, Toronto.

Editorial

LOOKING AHEAD

THE PROBLEMS of the Canadian accounting profession are not unique. Similar situations exist elsewhere and over the years we have learned much from watching the solutions attempted by members of the profession in other countries.

One problem which has a high priority in the minds of our members concerns the training of students. Is it too strongly slanted towards professional practice, in view of the fact that half of our students will eventually leave practice to assume positions in industry? In considering this, where better could we look for guidance than to Scotland, a country which gives to education a status not elsewhere accorded it; and particularly so, since this same student problem is receiving the careful consideration of the Scottish Institute?

In a recent address, Sir Ian Bolton, president of the Institute of Chartered Accountants of Scotland, had the following to say on the subject:

"We are now entering an era when we must grapple with the problems of the profession and do all that we can to see that our members are equipped to give the fullest possible service in the ever widening fields open to professionally qualified accountants.

"The problem is two-fold. It involves training both for the profession itself and for industry. As regards the former, we must ask ourselves is the present training sufficient? In our drive to implant knowledge into the students, do we produce capable thinking men and women – which is what our aim should be, or do we produce chartered accountants stuffed with crammed answers who have 'qualified' but cannot apply their knowledge? We must solve this problem for ourselves and quickly, for the sake of our clients and the future of the profession.

"Now as regards industry. Industrialists speak with two voices. Most of them try to attract our qualified men into their employment.

Unless they were satisfied with our men, presumably they would not do this. Possibly they cannot, at the moment, find others equally suitable, so that our professional offices tend to become a training school for industry. Is this trend a good one?

"Some industrialists are much more critical. They speak of electronics and other new devices and new techniques of auditing and preparing figures for day to day use by management. They tell us that we accountants are out of date – that industry, although bound by legal requirements as regards the auditing of financial statements, really requires industrial accountants, expert in their chosen trade, who will digest and interpret current figures and trends for management, who can then take action on them. These industrialists go further. They would have us train chartered accountants as management consultants, man-managers and the like. If they are correct, what new practical training is to go in the syllabus?

"Our proper attitude is to make certain that our syllabus is constantly kept up to date in the light of modern conditions. The objective should be to produce a man or woman qualified in modern accountancy, of balanced personality, of an enquiring and therefore receptive mind and capable, on entering industry, of building on the foundations we have laid; a man or woman with a background of integrity and common sense, ready to acquire the technique of his or her new trade, whatever it may be.

"The practising 'Master' must realize where the profession is going and may go. He must keep himself up to date and strive even harder than before to give his student not only a sound training in the subjects of our syllabus and the practice of the profession, but above all, an attitude of mind to life. The student must be led to face new problems as they arise and to acquire skill and confidence in unravelling them. Once this attitude of mind has been acquired, it is immaterial whether the problems to be faced are those arising in professional accountancy or in some complex industry of the future bristling with electronic brains and magic computers. It is safe to say that in the long run none of them will supplant human judgment though they may lift its exercise to higher planes."

This seems sensible advice and there is nothing in these remarks which would not be equally applicable coming from the president of any of our Provincial Institutes.

The Case for Social Accounting

J. E. SMYTH

"The preparation and interpretation of over-all economic statistics in financial statement form is a procedure that has come to be known as social accounting." — Morris A. Copeland in THE ACCOUNTING REVIEW, *July 1949.*

SOCIAL ACCOUNTING, a fascinating new extension of accounting, comes, in part at least, within the accountant's terms of reference because of its concern with the recording of transactions, the presentation of financial data in statement form, and the measurement of income: all topics to which the professional accountant has already given a great deal of thought.

There is, in addition, an argument for a wider understanding of the objectives of social accounting which touches on every-day professional practice. If the practising accountant is familiar with the meaning of *national income, gross national product, gross national expenditure, consumption, saving,* and *investment,* he may then find the published data on them of assistance in interpreting operating results to management. Such data can be of help in assessing the results of an individual firm as against developments in the industry and in the economy as a whole.

Concepts Employed in Social Accounting

National income consists of the compensation of employees, military pay, investment income (including profits of companies, interest, and rental income of persons), profits of farms and profits of unincorporated businesses (including independent professional practitioners). For the four years 1951-1954 the national income of Canada has been estimated as follows:

1951	$17,138,000,000
1952	18,326,000,000
1953	19,156,000,000
1954	18,774,000,000

Source of data: *National Accounts Income and Expenditure 1951-1954* (Dominion Bureau of Statistics), page 16.

Gross national product: "The total market value that has been created by the productive activity of the economy over the period of a year."[1] In discussing the calculation of gross

[1] R. Ruggles: *National Income and Income Analysis* (1949), page 45.

national product, S. A. Goldberg, the Assistant Dominion Statistician, has said, "Our objective is to arrive at a complete measurement of the nation's output of goods and services, without duplication."[2] The gross national product of Canada for the years 1951-54 has been estimated as follows:

1951	$21,474,000,000
1952	23,255,000,000
1953	24,449,000,000
1954	24,041,000,000

Source of data: ibid, page 16.

Gross national expenditure consists of all final sales, plus (or minus) the increase (or decrease) in the inventories of the selling entities. These "final sales" may be made to individuals in Canada (either in the role of consumers or of purchasers of durable assets), to municipal, provincial and federal governments, to other businesses in the form of fixed assets, and to persons and businesses outside the country (exports).

The sales to persons and businesses outside Canada are part of the total output of the Canadian economy during the year and are included in gross national expenditure, as part of the purchasing activity which has taken place within the country during the year. On the other hand, all imports become a part of the final sales or additions to inventories which take place within Canada; they do not represent a part of Canadian production and are deducted from total final sales and inventory changes in computing gross national expenditure.[3]

Since all production within the country must either be sold or result in an increase in inventories, gross national product (which measures productive input) must be equal to gross national expenditure (which measures final sales and changes in inventories). In other words, national "input" is equal to national "output"; the creation of goods and services is equal to the disposition of goods and services. This identity provides the basis for the national income and product account explained below.

Production: "The bringing into being of new goods and services through the transformation of materials, labour, capital and other inputs".[4]

Consumption: "Using up the fruits of production to satisfy current needs."[5]

Investment: "Diverting part of the fruits of production to provide for future needs."[6]

Saving: Saving is the opposite of consumption, not the opposite of spending. "When a person saves, he uses a part of his income to make an addition to his assets; he is still saving whatever form the additional assets take. Thus one possible way for a person to save would be by purchasing new equipment directly, and adding it to the assets in his possession at the end of the year."[7]

Sectors: Areas of similar operation

[2] S. A. Goldberg: "The National Accounts —Concepts and Applications", *The Canadian Journal of Agricultural Economics*, Spring 1954, page 6.

[3] See S. A. Goldberg: "The Development of National Accounts in Canada", *The Canadian Journal of Economics and Political Science*, February 1949, pages 38-39.

[4] S. A. Goldberg: "The National Accounts — Concepts and Applications", *Canadian Journal of Agricultural Economics*, Spring 1954, page 3.

[5] ibid, page 3.

[6] ibid, page 3.

[7] J. R. Hicks: *The Social Framework*, page 109.

within the economy. Thus we may speak of the "business sector" the "personal sector" (individuals and households) and the "government sector". In turn, the business sector may be broken down into separate sectors for each of financial institutions, manufacturing businesses, wholesale and retail businesses, and transportation concerns.

Types of Financial Statements

The end-products of social accounting to date have been four types of financial statements. These are, briefly,

1. The national income and product account (described below).
2. Statements of sources and applications of funds for various "sectors" of the economy (e.g. persons; manufacturing; utilities; transportation; wholesale and retail; financial institutions; and government).
3. The balance of payments statement, disclosing transactions with the rest of the world.
4. Input-output tables, which attempt to show both the industries producing goods and services and the industries purchasing them.

Thus while we have a national income statement, (item 1 above), we have not yet a national balance sheet, though it is recognized that the two statements are complementary in an accounting sense. The national balance sheet has been delayed because of the present inadequacy of statistical material and unresolved problems about "valuing" the national assets.

The National Income and Product Account

This account may be presented with two equal sides which are reminiscent of the debit and credit sides of the familiar profit and loss account, as shown at the top of the next page.

The analogy between the national income and product account, above, and a profit and loss account in the general ledger of an individual firm may be brought out by noting that in each case the left hand side of the account records, in general, costs (including profits, as the cost of risk-taking and "entrepreneurship"); the right hand side, sales.

Two modifications are, however, introduced into the national income and product account. In the first place we are interested in total production rather than sales alone, and so the change in inventories is, in effect, transposed from the left hand to the right hand side of the account. In the profit and loss account for a firm, an increase in inventories acts as a reduction of costs of manufacturing in computing cost of goods sold as shown on the debit side of the account; in the national income and product account, an increase in inventories is treated as an addition to sales to show total production on the credit side.

A second modification is that purchases of materials do not appear on the debit side of the national income and product account. By the same token, the sales which appear on the credit side of the account are sales to ultimate consumers only — not sales from one business to another. The reason is that, in measuring gross national product and gross national expenditure we are concerned with the aggregate of goods and services becoming available during the year for final use and we should be counting the same goods more than once

CANADA
National Income and Product Account
for the year ended December 31, 1954
(in millions of dollars)

Gross National Product		*Gross National Expenditure*	
Wages, salaries and supplementary labour income	$11,989	Personal expenditure on consumer goods and services	$15,676
Military pay and allowances	367	Government expenditure on goods and services	4,361
Investment income	3,715	Gross domestic investment:	
Net income of unincorporated business:		New residential construction	1,166
Farms	1,058	New non-residential construction	1,676
Other unincorporated business	1,645	Change in inventories	(280)
		New machinery and equipment	1,711
Net national income at factor cost	$18,774	Exports of goods and services	5,136
Indirect taxes less subsidies	2,914	Deduct imports of goods and services	(5,562)
Depreciation allowances and similar business costs	2,511	Residual error of estimate	157
Residual error of estimate	(158)		
Gross national product	$24,041	Gross national expenditure	$24,041

Source of data: *National Accounts Income and Expenditure 1951-1954* (Dominion Bureau of Statistics), page 16. The data are not presented in the form of an account, as above, but in two separate tables, one for gross national product and one for gross national expenditure.

(at various stages of production) if we were to include purchases and sales of materials and services by one firm to another. Thus inter-firm purchases and sales are eliminated in preparing the national income and product account; the only purchases of materials which are not eliminated are purchases from outside the country (imports) and these appear as a deduction on the right hand side of the account, instead of as a cost on the left hand side.

The above account is designed to show: (i) the total final goods and services produced within the country during the year; (ii) the contributions of the various factors of production to the total output of the country; and (iii) the disposition of the gross national product in the way of sales to consumers, to government, inventory increases, and fixed asset increases.

In practice, the data of the national income and product account are supplemented by subsidiary statements for different sectors of the economy, so that publication of the account is accompanied by separate statements in the form of a "Business Operating Account", a "Government Revenue and Expenditures Account", a "Personal Income and Expenditures Account", and a "Non-Residents Revenue and Expenditures Account", (showing Canadian imports and exports). In addition, there are also published an "Investment Income Appropriation Account" (showing sources and dispositions of investment income) and a "National Saving and Investment Account" (illustrating the equality between total

saving in the economy and total investment).

The Uses of the National Accounts

For some, it may be sufficient to say that the information contained in the national accounts is of general interest to the ordinary citizen; although this is certainly not the only argument. The national accounts are also of use in formulating the economic policies of the government. A first approach to handling economic problems such as depressions or inflation is to know more about what is going on. With the national accounts we have at once a "statistical picture of the nation's economic achievements" and a means of studying economic behaviour.[8] The application of the national accounts in assisting in the formulation of government policy in the United States has been summed up as follows:

"Today, a very high proportion of all economic analysis is done within the framework of the national income and product accounts, though for many purposes additional data are also needed. We look to the breakdown of product to see the extent to which a boom in output reflects a rise in consumers' expenditures as compared, say, with business inventory accumulation; to appraise the relationships between the detailed items of consumers' expenditures and total business activity; to analyze the part that exports play; to determine whether the share of our current output going into capital formation is smaller or larger than in past periods; and to study the long-term and short-term trends in Government share of total output . . . . The personal income and expenditures account, which also shows personal saving, tells us whether people are spending a higher or lower proportion of their income than normally; the breakdown of personal saving into components is necessary for analyzing the role of individuals in the capital markets, the success of Government bond drives, the effect of Social Security programs on private insurance, or the effectiveness of credit regulation."[9]

Another possible use for the national accounts lies, as noted previously, in their use in interpreting the operating results of individual businesses. In addition, they are of use in budgeting and in forecasting the market situation, and some large firms and marketing research organizations now use the national accounts as a framework for forecasting. It is probably true to say that they have not yet gained a wide usage along these lines, but there are hopeful signs in the recent experience of the Dominion Bureau of Statistics:

"The number of requests received by the Bureau regarding materials on the National Accounts from corporations, financial houses, trade associations, labour groups and others testifies to the growing use that is being made of the National Accounts in the business world for studying economic trends and analyzing business problems. The usefulness of the data for many specific purposes such as the study of markets, the relative importance of particular industries or groups of commodities in the econ-

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[8] See S. A. Goldberg: "The National Accounts — Whither Now?", a paper given at the meetings of the Canadian Political Science Association, June 1955.

[9] Irwin Friend: "Financial Statements for the Economy", *The Accounting Review*, July 1949, page 243.

omy as a whole, regional variations in income, and so on, is generally recognized. With a set of accounts to guide him the executive is able to visualize more clearly the complex processes which take place in the economy and their inter-relationships."[10]

The Place of Social Accounting in Accounting Instruction

It is, finally, the writer's contention that some study of the national accounts deserves a place in accounting instruction – not perhaps as a whole subject or course in itself but as an additional topic for consideration in one of the more senior years of instruction. For example, the topic may be introduced neatly after consolidations, as an extension of that technique.

It is always a stimulating exercise to consider what changes in thinking are necessitated by switching attention from the single firm to the whole of an industry, or to the whole economy. The philosophy of Accounting, as the subject is presently taught, is dominated by the outlook of the single firm and the individual businessman. There is nothing wrong with such an emphasis, of course, but it is at least useful to realize that it exists. For example, some of the things which the accountant calls "assets" are assets from the point of view of the individual person or business, but they are not assets from the point of view of the economy as a whole. A consideration of what a national balance sheet would look like will show that many "assets" which derive their value from their enforceability against other businesses or financial institutions (e.g. money, accounts receivable, bonds and shares) cancel out in the consolidation when determining the assets of the country as a whole: only the so-called "real" assets (inventories and fixed assets) and net claims against foreigners survive.

Another point which can be made is that the operating results of an individual business are to be explained both by forces operating within the business (internal factors) and forces operating outside the business in the industry or the economy as a whole (external forces). The techniques of accounting as developed for the individual firm, including cost accounting, are primarily concerned with the operation of the internal factors; for the significance of the external forces we must turn to social accounting.

One further point: the techniques of social accounting, as has been mentioned, lend themselves to the formulation of economic policy and the direction of the economy by government. The philosophy of business accounting (and of accountants) may, or may not, be in agreement with such developments; in either case, it is well to know something about the subject.

The Need for Participation by Accountants

The following quotations taken from a number of articles on the subject of social accounting will serve to emphasize the desirability that accountants should take a greater interest in this field:

"It is one of the inevitable accompaniments of the rapid growth of accounting that neither teachers nor practitioners have had the leisure to

[10] S. A. Goldberg: "The National Accounts – Whither Now?" ibid.

examine critically the uses to which the products of their art have been devoted."[11]

"I have already pointed out the dependence of systems of national accounts on accounting *concepts*. Accounting *data* in turn – such as net sales, cost of goods sold, profits after taxes, dividend payments, capital expenditures, and balance sheet items – are basic to the actual estimates."[12]

"Two alternatives are apparent; either we can educate the public to understand what is done, or we can try to do it in a way that is already somewhat familiar to the public, especially if that way will lead us to a more useful result. The second alternative is the one here advocated; national accounts should be set up and the national report rendered in a way that as nearly as possible parallels business accounting and reporting. Millions of businessmen, m... of stockholders and millions of students are familiar with business accounting and reports, and the trend is strongly toward increasing that knowledge, especially in this day of an all-pervasive income tax."[13]

"It seems fair to say that accountants have not contributed much to social accounting thus far. But their help is urgently needed."[14]

"To date this work has progressed almost entirely without participation from accountants. This lack of participation has, I think, been unfortunate. Accounting participation might have served to accelerate certain developments. It should not have taken so long to realize, as Hagen notes, 'that national income measurement is best thought of as double entry bookkeeping' . . . . a perception that at once made clear 'the exact relationship between income and output'. Moreover, the process of analysis has not been carried through to its ultimate conclusion. It is particularly deficient on the balance-sheet, and especially the equity, side."[15]

"The measurement of national wealth has still to be adequately superimposed upon this structure. Nevertheless, the problem has been posed and national balance sheets are both academically and administratively very much in the forefront of social accounting research. This rounding off in national accounting technique must surely bring it home to professional accountants that the pattern of social accounts is not dissimilar to the form of those financial accounts which constitute the familiar part of their own experience. And so, at long last, the appurtenances of the practical accountant are seen to converge upon the techniques of the applied economist."[16]

"There is a widespread recognition of the advantages of an accounting

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[11] E. L. Kohler: "Accounting Concepts and National Income", *The Accounting Review,* January 1952, page 50.

[12] Irwin Friend: "Financial statements for the Economy", *The Accounting Review,* July 1949, page 247.

[13] P. Kircher: "Accounting Entries and National Accounts", *The Accounting Review,* April 1953, page 192.

[14] Morris A. Copeland: "Social Accounting for Moneyflows", *The Accounting Review,* July 1949, page 264.

[15] W. W. Cooper: "Social Accounting: An Invitation to the Accounting Profession", *The Accounting Review,* July 1949, page 234.

[16] F. S. Bray: "Design for the Accounts of Society", *Accounting Research,* January 1952, page 16.

approach and an accounting form of presentation. Less generally recognized is the advantage of gaining the cooperation of the professional accountant in a field which has hitherto been the preserve of the economist and statistician."[17]

"Scientific accounting has now been developing for some 50 years, but I cannot trace that it has yet made a single substantial contribution to economic science over its own field of analysis of the results of industry, although it has practically a monopoly grip of the required data."[18]

The techniques of social accounting are still relatively new — the period since the last war has seen much of their development — and the amount of work to be done in this field will almost inevitably expand. It remains to be decided, however, whether the accountant will play any important part in the development of social accounting.

[17] R. Stone in *Lessons of the British War Economy* (D. N. Chester editor) quoted by F. S. Bray, ibid.

[18] Sir Josiah Stamp: *Studies in Current Problems in Finance and Government* (London, 1924), page 16; quoted by C. A. Ashley, *Corporation Finance*, page 220.

A Brighter Future for Atlantic Provinces

It is no secret that the Maritime Provinces have long been regarded as the Cinderella of Confederation — a Cinderella, moreover, to whom no glass slipper has yet brought emancipation from its disabilities. It is now recognized by the Provinces of the Atlantic Seaboard, however, that their common problems can best be attacked by joint action. This has led to the first experiment in this country in extensive co-operation on a regional basis. The experiment is being conducted by the newly-organized Atlantic Provinces Economic Council (APEC), fashioned along the lines of a similar council successfully conducted by the neighbouring New England States for many years. The Council is not government sponsored, but it has the approval and blessing of the governments of the provinces concerned.

Committees have been established covering agriculture, electric power, tourism, trade and membership. The prime aim of the Agricultural Committee is to increase the proportion of food requirements supplied locally by the adoption of a long-term production program based on foreseeable market demand, rather than on one influenced by temporary conditions. The Electric Power Committee is primarily interested in reducing the cost of power in the Maritimes and in making more efficient use of existing resources. The Tourist Committee has the task of co-ordinating the efforts of many groups interested in this industry; the carrying out of a research program on a regional basis and integrated promotional activities are under consideration.

The scope of the Council's endeavours may eventually be enlarged beyond that now covered by existing committees, and the great need for providing new capital is regarded as likely to become an important part of its efforts.

— Canadian Bank of Commerce Commercial Letter, Feb. 1956.

A Budget for Saskatchewan Road Transportation

F. G. COPITHORNE

IN ITS EARLY days, the present Saskatchewan Government became aware that the main centres of population were reasonably close to being adequately served with transportation but that about half of the population – which was thinly scattered over 150,000 square miles comprising the settled part of the Province – could never hope to get adequate bus transportation from private operators. Therefore, in the spring of 1946, it set up a Crown company under the name of Saskatchewan Transportation Company.

This company now operates six "commercial" routes between the principal cities and a far flung network of public service routes serving the outlying areas.

Extent of Operations

Saskatchewan Transportation Company has grown from two buses operating a total of 4,868 miles in March, 1946, to about 60 buses operating over 3,000,000 miles a year in the scheduled service and more than 100,000 miles in chartered service. In the most recent year they carried 531,782 passengers – a total of 39,383,376 miles.

In addition to its regular services, the company operates three "Express" services. These are through services, with no scheduled stops, put on by the company in an effort to gain traffic from the private automobile. Only the newest luxury equipment is used on them and the passengers reserve individual seats on each bus. Every passenger receives a free daily newspaper with the compliments of the company.

This company has recently introduced another innovation, that of credit cards for the use of its regular patrons. These credit cards are used much as gasoline credit cards. The intending rider presents his card to the ticket sales clerk who fills out a requisition form which the patron then signs. A bill is sent to the patron at the end of each month for cost of all travel during that month. As far as is known, S.T.C. is the first bus company anywhere to try out the credit card system.

Another "first" for this company is the extension of these credit cards for the hire of U-drive cars. The principal centres of the population in Saskatchewan are 100 to 200 miles apart and there are many cases where businessmen and others would glad-

ly use the deluxe bus service provided but for the fact that they need automobiles at their destination for business purposes. Now, all that they have to do is to send in their credit cards to S.T.C. for validation and then they can use them for hiring U-drive cars at their destination.

As well as a bus service, the Saskatchewan Transportation Company operates a freight transport service on a public service basis from Prince Albert northward. In addition, a "Cat Swing" is operated to the more remote parts in the far north of the Province "packing in" supplies to Hudson's Bay Company and Saskatchewan Government trading posts and to other traders for the use of trappers and prospectors, and bringing out furs.

Structural Reorganization

During the past year the internal structure of S.T.C. has been reorganized and it has now a streamlined organization on the most modern lines. There are three main departments — operations, sales and office. The institution of a sales department in a bus business was, when it was planned, unique among bus companies. This lead has now been copied by some of the largest bus companies on the continent.

In the reorganization three principal objectives were kept in mind:

(1) The formation of a sales department.

(2) A clear definition of responsibility and authority.

(3) The necessity for better control of operations through an operating budget.

In regard to the first objective, there had not previously been recognition of the sales function as such. There had been "ticket agents to sell the public the tickets they asked for and take the requisite amount of money in payment. The members of the new sales department were told that their duty was to "make twice as many people want to go twice as far, twice as often".

As for the second objective, there was a need for a clear definition of authority and responsibility if there was to be an effective operation. There was also a need for some delineation of functions. For example, the maintenance superintendent at Regina had technical supervision over the quality and type of work being done in outlying garages, although the foremen of those garages were responsible to the local superintendents. Similarly there was need to define the responsibility for technical supervision from head office of the efforts of the ticket office staffs in areas at outlying depots who reported to the local superintendent also.

Thirdly, it was deemed desirable to institute a flexible operating budget, the installing of which merits a detailed description.

Preparation of a Budget

In making up this budget it had to be kept in mind all the time that the operations of this company differ from those of most other bus companies to an outstanding degree in two ways:

(1) Revenue in the high month of the year has been as much as five times as great as that in the low month, compared with a normal variation in other areas of just one and one-half times as great.

(2) Traffic on week-ends runs as high as three times that in mid-week.

whereas many companies find the week-end is their low point.

In order to take the first point into account, it was decided to make up twelve budgets and then add them together for the year's budget. From the second point, it will be seen that a substantial part of the equipment and organization which must be provided lies idle the greater part of its time.

In preparing the budget it was decided that accounts would be divided into three classifications: fixed, such as depreciation of depots, management salaries, etc.; variable, such as fuel for the buses and drivers' wages; and mixed.

The year's depreciation on buildings and equipment, other than buses, and the total amount of management's salaries and other items were calculated and spread evenly over the 12 months. Perhaps we should have allocated the cost of keeping facilities available — such as depots and garages — to the different months in varying amounts so that the facilities held available for peak loads and peak months would be more nearly correctly charged against those months' respective operations.

Depreciation on buses was put in the category of variable expenses and budgeted for month by month on the basis of the expected revenue miles.

Variable expenses were primarily based on an estimate of revenue miles, month by month, prepared by the operations department. They prepared this using their knowledge of the planned schedules and their experience with "overloads" (second and third sections, etc.) during peak periods.

From this table of estimated miles to be operated on every route and totalled for each month of the year, the operations department laid the plans as to what type of equipment it would use and, from that, estimated the mileage to be put on by each type of equipment month by month. In doing this, they had to consider also how many of each type would be placed at each despatching point for the year, taking into account such questions as the kind of service to be provided.

Standard allowances were then calculated for each account each month. These were based on actual price levels for the preceding period in the case of both materials and wages, adjusted for known variations. The principal variations are changes in the contract prices for gasoline, oil and tires, and changes in the wage rates in the union agreement. These allowances were broken down as fine as was found practicable, trying at all times to finish with a group of accounts and a monthly expense allowance corresponding as closely as possible to a given person's responsibility.

An Illustration

To illustrate: the accounts for which the operations superintendents are held responsible are in three groups:

(1) Transportation / Operations
(2) Equipment maintenance and garage expense
(3) Station expenses.

The first group, Transportation / Operations, includes the accounts:

Engine fuel, engine oil
Drivers' wages
Supervision of transportation — salaries

Miscellaneous transportation salaries
Supervisors' travelling and other expenses
Drivers' rooms
Drivers' expense allowances
Road expenses
Ferry and entrance tolls
Purchased transportation
Other transportation expense.

The first six of these are self-explanatory. The seventh, "drivers' rooms", is the cost of room rent paid by the company for drivers when their operating schedule requires them to spend the night away from their home point. Likewise, "drivers' allowances" is the cost of expense allowances to drivers for meals, etc., when away from home on chartered or other trips. "Road expenses" include towing charges when the buses get stuck in snow or mud. "Purchased transportation" includes the cost of transportation by rail, taxi or otherwise, provided for persons bearing S.T.C. tickets when it is impossible for any reason to carry them on S.T.C. buses. It also includes the cost of taxis or other equipment hired to carry small overloads.

The title of the second group "Equipment maintenance and garage expense" is self-explanatory.

"Station expenses" covers the cost of operating the company's depots, commissions paid to the operators of about 300 agencies scattered throughout the company's system, and commissions paid to other bus companies for that portion of tickets sold by them which are used over S.T.C. lines.

The remainder of the expense budget is computed in the same fashion and tabulated month by month to get the year's budget.

Revenues and the Weather

On plotting the fare revenues of the company month by month for a number of years past a clear, typical, seasonable pattern can immediately be seen and it is found upon study that almost every material deviation throughout the company's history can be readily identified with variations from normal weather conditions as reported by the Department of Transport Meteorological Office.

It is then necessary to make a prediction as to what will be the weather conditions for the ensuing financial year and here the path pursued is one of "cautious optimism". A level of revenues, month by month, has been assumed which is somewhere in that region "better than the worst but not as good as the best". It should be pointed out that it is not possible, in a service industry such as transportation, to sell goods or withhold them from the market, according to the market conditions of the moment. Once a schedule has been set the bus must be run if physically possible, regardless of whether it is full or empty. This is one of the reasons why so many claim that it is impossible to operate budgetary control in a service industry.

In addition to fare revenues, there is, of course, a substantial revenue from charters, parcel express, mail, newspapers, baggage, commissions earned from other companies and from such concessions as depot lunches. These are estimated on the basis of past experience, adjusted for known or expected variations.

Application of the Budget

The next step is the actual application of the budget.

Each month, immediately the number of bus miles travelled in the previous month is known, a revised budget is computed using actual bus miles, rather than forecast miles, to arrive at the "expense allowances" for the month. Then in such accounts as gas and oil, drivers' wages and others, keyed directly to the number of miles run, the adjusted budget against which the actual expenses for the month are matched is a realistic and reasonable figure; that is, if the cost estimates per mile are reasonable. Those comparisons of actual expenses against current allowances are then given to department heads for analysis and explanation of the variances. They, in turn, go down the line in their departments to try to account for the variances. This information is set up in exhibit A shown below with unfavourable variances designated by an asterisk. (In this exhibit imaginary figures are used for illustration purposes.) The major changes in the financial results for the month are restated in exhibit B and the information is again summarized in exhibit C.

This operating budget has not yet been in use very long (this is the first year) and notes are being made of lessons learned to apply to the preparation of next year's budget. Some of these are:

When the next year's budget is compiled the monthly allowance for maintenance and repairs to buses will be calculated by adding together two allowances. One is based on the miles run to cover routine servicing and maintenance of the buses actually in service, and the other is a lump sum allowance for pre-planned major overhaul jobs.

In a system such as this, all possible overhauls and all foreseeable repairs must be done at slack times so as to have the vehicles free for service to some extent, in inverse ratio to the miles run in a given month. From this it will be seen that a current allowance based upon the number of miles run is far from being a fair criterion to apply to the month's actual expenses in this department.

The other needed correction to the method used this year has already been hinted at. Some method should be devised to charge the peak periods with the considerable cost of providing equipment and other facilities to carry the peak loads and not unduly saddle the slack months with a cost attributable to the other periods.

Uses of the Budget

Operating budgets are usually regarded in one of three ways:

1. Operations control
2. Cost control
3. Cost reduction.

The Saskatchewan Transportation Company looks on its operating budget first as a method of operations control. "Do department heads lay logical plans and then analyze variations from these plans, as a guide to future action?" is one of the questions asked.

Secondly, the budget is a means of cost control. "Were the costs and the revenues just about what was expected?" If not, what was the cause? Should costs be greater, to give optimum results, or less?

To be most useful a budget has to be realistic. It is good to see just about as many favourable as unfavourable variances at month ends. Then the department heads and their staffs know that they can make a good showing and react accordingly.

Exhibit "A"

SASKATCHEWAN TRANSPORTATION COMPANY
COST AND VARIANCE STATEMENT
TRANSPORTATION

MONTH OF MAY, 1955				*YEAR TO DATE*	
Current Allowance	*Actual*	*Variance*	*Account*	*Actual*	*Variance*
			Labor:		
12,690	12,430	260	Drivers' Wages	122,390	760
2,250	2,250	—	Superv. Salaries	15,878	210
395	400	5*	Misc. Transp. Sal.	2,725	15*
			Expense:		
3,316	3,061	255	Diesel Fuel	20,037	375
3,629	3,617	12	Gasoline	52,162	159*
345	249	96	Engine Oil	2,936	155
230	360	130*	Superv. Transp. Travel	2,229	314*
650	644	6	Drivers' Rooms	4,669	15
175	99	76	Drivers' Expenses	896	183
75	163	88*	Road Expenses	690	148*
4	—	4	Ferry & Entrance Tolls	—	8
—	—	—	Bus Supplies	13	11*
70	220	150*	Purchased Transport.	1,400	1,210*
40	17	23	Other Expense	183	43*
23,869	23,510	359		226,208	194*

Exhibit "B"

SASKATCHEWAN TRANSPORTATION COMPANY
ANALYSIS OF VARIATIONS, MAY, 1955

Budgeted Profit		$32,450
Add:		
Increase in revenue	$15,175	
Less: Increase in expense allowances	1,519	13,656
Adjusted Budgeted Profit		$46,106
Add:		
Favourable variance in expenditures — as below		289
Actual Profit		$46,395

PRINCIPAL ITEMS COMPRISING
FAVOURABLE VARIANCE IN EXPENDITURES

Drivers' wages less than budget	$260
Diesel fuel consumption low	255
Engine oil usage low	96
Maintenance supervisor visit to factory	130*
Purchased transportation	150*
	$331

Exhibit "C"

SASKATCHEWAN TRANSPORTATION COMPANY

STATEMENT OF BUS OPERATIONS

May, 1955

REVENUE:	*Budget*		*Actual*	*Variance*
Fares	110,000		113,000	13,000
Charters	4,000		6,400	2,400
Express	5,500		4,725	775*
Mail	600		625	25
Papers	1,500		1,400	100*
Baggage	700		725	25
Commission Earned	2,300		1,700	600*
Miscellaneous	4,800		6,000	1,200
	119,400		134,575	15,175

EXPENSES:	*Budget*	*Adjusted Budget*	*Actual*	*Variance*
Maintenance of Equipment	22,500	23,000	23,100	100
Transportation	23,250	23,869	23,510	359
Insurance & Safety	5,000	5,100	5,200	100*
Depreciation	12,000	12,100	11,850	250
Licences & Taxes	3,100	3,100	3,150	50*
Operating Rents	100	100	70	30
Station Expense	8,000	8,000	8,200	200*
Sales Department	8,000	8,000	7,600	400
General & Admin.	5,000	5,000	5,500	500*
	86,950	88,469	88,180	289
OPERATING PROFIT OR LOSS	32,450	30,931	46,395	15,464

Taxes and Canada's Economic Troubles

A study prepared for the Gordon Commission on Canada's Economic Prospects by some of the partners and associates of Clarkson, Gordon & Company

Last July the Gordon Commission on Canada's Economic Prospects asked for a study of the tax rates and policies which may have influenced investment in Canadian industry. Here is a digest of the brief which was prepared for the Commission as a public service.

THE course of world affairs since the end of the war has brought into play certain very important influences, economic, political and financial, which have had a great deal to do with the rapid growth of foreign investment in Canada. While it would be wrong to assert that tax considerations were primarily responsible for this growth, it is undoubtedly true that in two ways at least taxation has played a considerable part in shaping the pattern which has developed.

Most of the recent increase in foreign investment in Canada has come from the United States and it is evident that the taxation system in that country, particularly since 1950, has provided strong incentives to the investment of capital in other countries. In particular, the excess profits tax re-enacted in 1950 and in force until 1953 brought about a situation where profits otherwise taxable at rates as high as 82% could be used to blot up preliminary losses resulting from development of new businesses. In the case of the petroleum industry in particular, a good deal of such money found its way into Canada.

The second important influence has been the impact of our tax system upon the owners of Canadian businesses, rendering it difficult in many cases for them to retain control. While certain aspects of our tax structure provide incentives to investment in equities, the perennial problem of the joint impact of income tax and succession duty continues to provide a strong incentive to owners of small and medium-sized businesses to part with their investment in old age or when death occurs. Attempted remedies have all been designed to modify the income tax part of the problem, by making it easier or cheaper to withdraw funds to meet succession duties: nothing has yet been attempted, however, to relieve the financial crisis caused by the succession duties themselves.

We in Canada can obviously do nothing to control the incentives which other countries offer their citizens, and the suggestion that we should grant our taxpayers identical treatment is not completely practic-

able. The taxation systems of Canada, Great Britain and the United States have important and fundamental differences from one another. However, it is possible to amend our own tax structure in a number of respects, so as both to improve somewhat the lot of the Canadian owner of a business, and also to direct or influence the form of non-resident investment in this country.

With these objectives in view some points for consideration might be dealt with under the following headings:

(1) Possible changes in the taxation of income earned in Canada by non-residents,
(2) Changes designed to increase Canadian investment in equities and render it easier for Canadian owners to retain their investment in business, and
(3) The special problem of oil and gas taxation.

At their existing levels the Canadian taxes on dividend payments to investors in the U.S. and U.K. do not constitute a deterrent to investment in wholly-owned Canadian subsidiaries. This is because no tax whatever is withheld on dividends paid to United Kingdom parents of wholly-owned subsidiaries, and the 5% tax rate on dividends to United States parents is wholly absorbed against the higher United States tax rate on corporate profits. In contrast the higher withholding rate of 15% imposed on dividends of Canadian companies which are not wholly-owned (or where the United States treaty applies, are less than 95% owned) creates a substantial penalty where any significant minority exists. This constitutes a real deterrent to permitting participation by Canadians in foreign controlled Canadian business; and to those who argue that such participation should be freely offered, the non-resident owners can point out that our Canadian tax laws are so drawn as to penalize a company when it grants the right of participation to Canadians. Therefore, in the public interest, it would appear only logical to abolish the discrimination which now exists.

In removing this discrimination between wholly-owned and partly-owned subsidiaries, it may be desirable to continue the differentiation between casual investors abroad and corporations which in effect control Canadian businesses by taxing dividends at different rates. If so, it will be necessary to define the extent of stock ownership which will for this purpose qualify the foreign shareholder as a controlling corporation. A reasonable level, having in mind the desire to encourage Canadian participation, should certainly be no higher than 50%, and it might be advisable to drop the percentage still lower.

The most common form in which foreign owners carry on business in Canada is through a Canadian subsidiary company. Our scheme of taxation provides for the payment of tax by such subsidiary on the same basis as any other Canadian corporation and, in addition, we impose a withholding tax on dividends sent abroad. There is, however, a considerable (and growing) volume of investment in Canada by non-residents who, instead of incorporating Canadian subsidiaries, operate in Canada as foreign corporations. The profits earned by such corporations in Canada are taxed in the same manner as are the profits of Canadian compan-

ies, but yet there is no additional tax upon the movement out of Canada of their profits, similar to the withholding tax on dividends paid by the Canadian subsidiary. So long as this inconsistency remains, it will obviously serve as a deterrent to Canadian participation in foreign controlled business in Canada.

The whole scheme of withholding taxes on remittances abroad of other than dividends paid by corporations should be re-examined in order to study the extent to which these taxes might be used to direct foreign capital into certain specific types of investment.

Consideration might be given to offering positive inducements by way of tax concession to at least three classes of investment where increased foreign participation might be desirable.

The first is the financing of Provinces and municipalities. No Canadian withholding tax is imposed on interest on Government of Canada bonds, nor is any tax withheld on interest payable in foreign currency on municipal and provincial bonds. However, where this interest is payable in Canadian currency, withholding tax is payable at the rate of 5% on interest on provincial bonds and at 15% on interest on municipal bonds. The financing of provincial and municipal expenditures in this growing economy presents a formidable problem. Consideration might, therefore, be given to exempting all interest on provincial and municipal bonds from the payment of any non-resident withholding tax.

So far as individuals and fully taxable corporate investors are concerned, the elimination of this tax might have no more than a psychological effect because, in the main, the tax now withheld is recoverable as credit against United States tax. There is, however, a substantial volume of funds available for investment by non-taxable organizations, pension trusts, charitable institutions and regulated investment companies. There is also a very large volume of investment by United States life insurance companies which pay a relatively low rate of tax (from 3¾% to 6½% on investment income) and which consequently are not in a position to recover fully a 15% Canadian tax. There would appear to be a possibility of attracting considerable United States capital to this class of investment, particularly as in the United States interest on state and municipal obligations is completely free of income tax, with the result that yields are extremely low and such investments are unattractive except to those taxable in very high brackets.

The second possible change in our withholding taxes relates to the income from investment in real estate. At present the 15% withholding tax applicable to rentals is applied to the gross income, without any deductions for depreciation, taxes, repairs, insurance, or mortgage interest. Under an option, however, the non-resident investor may file a Canadian tax return and pay on the net income at the same rates as a resident of Canada; this is equivalent to treating him as though the ownership of real estate represented the carrying on of business. The ownership of real estate by a non-resident might perhaps be regarded simply as an investment, and for that reason the normal withholding rate of 15% should be applied to the net income from the property. Such a change might have the effect

of attracting substantial amounts of foreign capital to this form of investment.

The third possible change is suggested by the obvious need for capital to help finance the very large development of housing in Canada. Until the 1954 amendment of the Bank Act, most of the funds required for National Housing Act housing were provided by life insurance companies and at December 31, 1953 almost 25% of the assets of Canadian life insurance companies was represented by mortgage loans. It may well be in the public interest that we should attempt to direct foreign capital into this area. If so, consideration might be given to providing a suitable incentive. Non-residents can, of course, under the present laws, limit their tax liability on interest income to 15% by the formation of a "non-resident-owned investment corporation". If a further incentive is to be offered, one might consider granting a lower rate of tax, say 5%, on a special type of company which would meet the present requirements of a non-resident owned investment corporation, with the additional stipulation that the income of the company consist principally of interest on National Housing Act mortgages.

The second group of changes which might be considered apply to the taxation of Canadians, with a view to increasing their participation in equity financing, and rendering it easier for Canadian owners to retain control of their own businesses.

First there are two non-tax factors which have a considerable importance in determining the manner of investment of the savings of the Canadian public. These are the prohibitions and restrictions against investment in equities of businesses, under the Trustee Acts of the several Provinves, and the federal law relating to life insurance companies. Although the long standing restrictions placed upon the investment powers of trustees are admittedly very important, it would appear reasonable to suggest that the whole question of trustees' investment powers should be reviewed in the light of the changed condition of our economy. It might well be found desirable to authorize, in certain circumstances and with appropriate safeguards, a limited power of investment in certain classes of business equities.

It is debatable whether the existing limitation on life insurance companies, namely, that investment in common shares may not exceed 15% of total assets, is too restrictive. The last published data show only about 5½% of the assets of Canadian life companies invested in stocks of all kinds and no one company was close to the 15% limit on common shares.

Under the existing rules of the Income Tax Department, the restrictions applicable to life insurance companies are likewise imposed upon pension fund trustees. The over-all effectiveness and ability of pension funds to provide reasonable benefits in old age would be greatly enhanced if a hedge against inflation were obtained by investing a significant portion of the fund in equities. Secondly, if after full consideration, it is decided that the present rules should remain unchanged, it would be preferable to have such laid down by legislation rather than arise through the exercise of administrative discretion.

The Income Tax Act, s. 69 contains special provisions for the taxation of

investment companies which meet the tests therein laid down. These conditions were considerably altered in the 1955 amendments of the Act, and in the course of making these changes, certain strong incentives to invest solely in Canadian equities were lost. While such companies must still obtain a minimum of 60% of their gross revenue from dividends of taxable Canadian companies, they may now so invest their funds that the other 40% of income may come from foreign dividends or foreign interest. In spite of this, the special tax of only 20% will apply and most of this will be recovered by the shareholders by way of dividend credit. A possible method of encouraging investment in Canadian equities beyond the minimum level now required, and at the same time discouraging investment in foreign securities, would be to create an additional requirement that in the aggregate not less than 95% of gross income must be derived from Canadian sources. This would still permit an investment trust to keep a substantial part of its funds in high grade securities.

One other possible change concerns the participants in profit sharing funds, the assets of which in many cases are invested in equities. To qualify as "profit sharing funds" under the Income Tax Act, all of the income must be allocated each year to the individual participants and they are taxed accordingly. There is, however, no provision whereby the benefit of the 20% dividend credit on dividends from taxable Canadian corporations can be passed on to the participants. For the sake of equity this situation should be corrected.

Changes in our succession duty laws are needed to maintain Canadian ownership of Canadian business. A major problem which has faced individual owners of Canadian businesses for many years is the double impact of succession duty and income tax.

Under United States law, an individual can leave up to 50% of his estate to his wife (or husband) free of tax. Where this is done, the total of the taxable estate being cut in half, the amount of duty which the estate must raise immediately is greatly reduced; also the duty is at a slightly lower rate. The laws relating to community property in the Province of Quebec afford a similar relief, and the adoption of such a provision uniformly across Canada would have a profound effect upon the ability of families to maintain control of their businesses.

This suggestion is by no means as radical as it may at first appear. The portion of the estate which goes tax-free to the spouse falls in its turn to be taxed upon the death of the spouse, so that the principal sacrifice of the revenue is in waiting a little longer for part of its duty. The practical benefits of such a scheme in the case of the aging businessman are extremely important. He is provided with a practical means of providing for his wife after his death and the dimensions of his succession duty problem are reduced very materially.

A further though less serious disability lies in the provisions of our gift tax legislation. In certain cases owners of businesses in Canada have sought to meet their prospective succession duty problem by making gifts to their children to enable the latter to purchase shares in the family business. Should the donor die within three years of making the gift,

under federal law the gift is deemed not to have been made, but the gift tax paid is allowed as a credit against succession duty. In the case of residents of the Province of Ontario and Quebec, however, which levy their own succession duties, the scheme for giving credit in respect of provincial duties in determining the federal tax is such that a portion of gift taxes paid may not be allowable as a deduction from succession duty. This hazard certainly tends to reduce the rate at which gifts are made in the circumstances under consideration, and a reasonable cure could be readily achieved by granting credit for the full amount of gift tax paid (within the three years preceding death) against the net federal duty otherwise payable.

Among the prospective buyers for any Canadian business are other Canadian corporations and individuals, as well as non-resident investors. In many cases, Canadian investors will seek to use a Canadian corporation as a vehicle for making the purchase and there are two provisions of our income tax law which may constitute obstacles to such purchase, but which do not handicap non-resident investors in the same manner.

Our law has for many years contained a provision that interest on money borrowed by a company and used to acquire an asset which produces tax exempt income shall not be allowable as a deduction in arriving at taxable income. Under this rule, it is not possible to obtain a deduction for interest paid on money borrowed to buy the shares of another company, the income therefrom in the form of dividends being exempt. While there is at first glance some considerable logic in this provision, it has no counterpart in the laws either of Great Britain or the United States, and there is no doubt that it serves to limit the activity of potential Canadian purchasers of businesses. When one realizes that the interest on a loan usually constitutes taxable income in the hands of the lender, there is a good deal to be said for the justice of allowing the interest cost as a deduction to the borrower.

The other and much more difficult problem which faces the Canadian corporate purchaser of an established company relates to what is called "designated surplus" by the Income Tax Act. The provisions under the Act are intended to prevent one corporation purchasing another and immediately withdrawing by way of tax-free dividends the surplus of the company acquired, and using the same to pay for the acquisition. The technique employed is to freeze the surplus of the company of which control is so acquired by another company and to limit the right to draw out tax-free dividends to profits earned subsequent to acquisition. While in a broad sense this appears a reasonable method of preventing abuses, the trouble is that the innocent suffer equally with the guilty. It has became virtually impossible to carry out certain inter-corporate transactions, mergers, and winding-ups of a character where freedom from tax on inter-company dividends would be totally unobjectionable. Further, until the 1955 amendments, the non-resident corporate investor was in a position to carry out with impunity the acquisition of Canadian businesses in exactly the circumstances which the designated surplus provisions of the law were designed to prevent.

While the solution to this problem is not simple, there are two possible improvements which appear worthy of present consideration. First, a limited right might be granted to carry out an amalgamation through liquidation of one company into another without any tax on surplus passing to the senior company, provided that it can be demonstrated that the combined undistributed incomes of both companies still exist in the continuing company. A test which should be met by the continuing company is that its net assets, after deducting any redeemable capital, should be equal at least to the combined undistributed incomes of the two companies prior to amalgamation. It should probably further be provided that the continuing company should not be entitled to a deduction from undistributed income in respect of capital losses which may emerge on the liquidation of its investment in the purchased company — if such loss were recognized it would to that extent extinguish undistributed income unless there were capital profits against which it would be offset.

The second possible change is suggested by the 1955 amendments which permit companies to be liquidated into the hands of an investment dealer upon the payment of a special tax of 20% (15% in the case of a non-resident). It would appear much simpler, for all concerned, to cut through the investment dealer technique and provide simply that in such circumstances the recipient company should pay a tax of 15% or 20% on any dividends which it receives from designated surplus.

Our Canadian tax system has often been criticized for placing the Canadian oil and gas operator at a disadvantage vis-a-vis United States competitors in the Canadian oil fields. This general complaint is based upon several different underlying factors. One is that the terms of the United States tax laws, particularly within the past five years, have offered incentives and concessions to their taxpayers which go considerably further than any similar concessions available to Canadians. Thus, wealthy individuals and corporations with profits subject to taxation at very high rates have been able to reduce their United States taxable incomes, and thus save large amounts of tax, by making expenditures in Canada in oil exploration or development. Much of the money at risk was tax money, particularly in years when excess profits taxes applied in the United States.

Another major factor lies in the different methods adopted by Canada and the U.S. in granting allowances for depletion. There can be no doubt that the Canadian allowances are considerably less generous than those available under United States law. A principal objection to the Canadian system is that it requires the writing-off of exploration and development expenses before arriving at the figure upon which the depletion allowance is calculated. As a result, once substantial production is reached, every additional dollar spent on exploration and development will serve to reduce the depletion allowance available. Thus, at a certain point in the program of a Canadian operator, the method of granting depletion introduces a strong incentive to stop exploration and development. In contrast, the United States system provides a continuing incentive to exploration and development because it is based on gross income (with a

limitation based on net income before deducting the expenses of unsuccessful exploration), but with an automatic option of cost depletion when it is the more favourable.

As far as Canadian taxation is concerned, operating results in Canada of both Canadian and United States operators receive identical treatment. The advantage of the U.S. operator, therefore, in what is referred to as improving his "competitive position" lies entirely in the manner in which he is able to reduce the taxes which he would otherwise pay in the United States, particularly in the exploration and development stages. It should be pointed out that, while these initial advantages are never lost, they cease once he has reached the point where income from production has absorbed all the initial costs. From that point forward, both operators are on an equal footing.

Among the suggestions for the improvement of the Canadian system, the one which appears to merit most serious consideration is the proposal to change the basis of the depletion allowance. If the allowance were changed to a percentage of gross revenue, or alternatively a percentage of net revenue before the deduction of any exploration and development expenses, the incentive value would be enhanced and the system should become more logical and desirable in that the incentive to cease exploration when production was secured would be removed.

A second important change which should receive consideration is to make available cost depletion as an alternative where the percentage depletion proves insufficient to cover the actual costs. Such a move would have obviously important results and improve the so-called competitive position of the Canadian operator, particularly in the case of high cost wells. Consideration might also be given to finding a better method of enabling the operator to write off, against income, the costs of unproductive and abandoned property. The present provision in this respect is extremely limited.

It is important to recognize that any such change in cost depletion and range of available write-offs will have an immediate and material effect upon the prices at which oil properties may change hands. Unless appropriate safeguards are developed, there would be an inevitable tendency to bid up the prices of oil properties. In such circumstances the treatment of the resulting profits in the hands of vendors would have to be considered. It is fair to say that unless some restraint was imposed in this connection, a serious loss of tax revenue would undoubtedly occur.

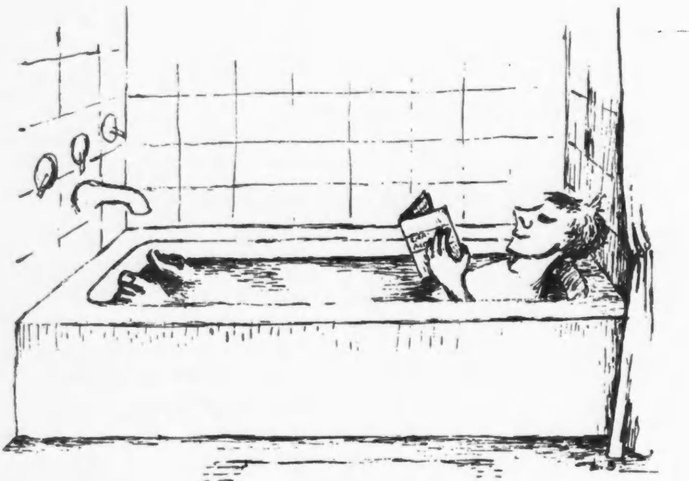
The over-all purpose which our method of taxing the oil industry should attempt to secure is that the operator should have a reasonable assurance that all of his costs will be deductible from the revenues which arise from his operations. In addition, there should be some recognition of the special risks and hazards inherent in this industry and it would obviously be desirable that, so far as possible, the incentives offered should apply in their fullest form where the risks are greatest.

In its present form our Canadian tax system falls short of these desirable objectives in several important ways, and in the public interest this situation should be corrected as quickly as possible. As has been

pointed out, however, there is no simple solution, and before any decisions are made as to specific changes in the law, there is need of most careful study of the subject by competent persons. The most effective way of bringing about a desirable revision of our laws will be to set up a special body, in committee or commission form, consisting of from three to five highly qualified individuals, and to set such committee the task of examining the problem in detail.

One final suggestion is made regarding the form of incentives offered by our tax laws. The extent to which incentive tax concessions should be made available to non-resident investors is essentially a matter of policy and the technical structure can be adjusted to carry out whatever results may be intended. There is danger, however, that without special safeguards some incentives made available to Canadians and non-residents alike may, as a result of foreign taxation, merely transfer the benefit to the treasury of the foreign country. Our three-year exemption for new mines is a case in point and the benefit of any reduction in Canadian taxes which a United States investor enjoys will probably, under the present rules, be transferred to the United States Treasury through a reduction of the tax credits allowable to the United States taxpayer.

A LAYMAN'S GLOSSARY OF ACCOUNTING TERMS



Liquid Position

Capital Gains Re-Examined

RALPH LOFFMARK

FROM A REVIEW of statutory provisions, regulations and judicial decisions, it appears to be well settled income tax law that to find taxable income the facts must indicate the taxpayer is deriving receipts in the course of carrying on a trade or business. What constitutes a trade or business is a matter of fact to be determined in each instance by an examination of the circumstances of the case. A number of factors have been found to be important in influencing the court to find that taxable income has been received or has accrued. Some of those factors which will receive consideration include:

1. The fact of repeated or single transactions.
2. The charter powers of a corporate taxpayer.
3. The taxpayer's manifest intentions in undertaking the activity.
4. The amount and type of work done on the subject matter of the revenue.
5. The characteristic activity and conduct of a person in the alleged trade or business.
6. The distinction between realization of gain as a part of "investing" as against gains from "trading" or "speculating".
7. The distinction between profits realized on disposal of fixed assets and corresponding gains realized from the sale of current assets and consumable stores.
8. The presence of an element of *quid pro quo* – an element of services rendered.

It should also be noted that the courts have not always been consistent in their use of the word "income". In some instances it has been used to refer to the actual cash receipt in much the same way as "revenue" is used in conventional accounting terminology. At other times, the context indicates that the court has intended "income" to mean the difference between the amount realized upon a sale and the cost of that sale. In the latter sense its meaning corresponds more closely to accounting usage. In either case, it is generally understood that taxable income is that profit remaining after deduction of costs associated with what may be termed the gross revenue.

Another characteristic of the judicial concept of income may be noted in the court's effort to differentiate between income resulting from the normal course of business activity and income from unusual and

isolated transactions. In principle, at least, the courts and the Department of National Revenue are in agreement with accounting authorities that ordinary business income represents the difference between revenue and the costs associated with the production of that revenue. However, in the case of gains made and losses incurred on transactions outside the main stream of business operations, neither the Crown nor the judiciary has followed any clearly delineated concept.

The Clean Surplus Theory

The accounting profession appears to have met the problem by the development of the clean surplus theory, whereby the income statement is divided into three distinct sections. The first part of the statement reports those transactions for which the enterprise was organized. The second part is an historical record of all the gains and losses realized on transactions which may be fairly said to fall outside the normal recurring activities of the business. The remainder of the statement recites the activities associated with the division and reservation of net earnings from all sources. Thus, the reader of the statement is presented with a record of all non-recurring transactions of any significance and is left to draw his own conclusions as to whether they represent income or capital gains and losses. The wisdom of this treatment becomes apparent when an examination is made of some of the cases where the transactions in question are not of a recurring nature so as to bring them clearly within the meaning of the expression, "carrying on of a trade or business", nor can they be classified as relating to either fixed or circulating capital.

To illustrate some of the latent difficulties provoked by the court's attempt to distinguish non-recurring gains and losses as either income or capital transactions, we may refer to a line of cases of which the following are representative.

A Matter of Proper Construction

C.I.R. v. *Ramsey,* 20 T.C. 79 involved the sale of property under circumstances which clearly excluded the receipt from the rule applicable to transactions in the nature of a trade or business. The taxpayer had contracted to sell a business for $15,000 on terms of $5,000 down and the balance to be made up by the payment over a period of ten years of a sum equal to 25% of the net yearly profits. If this amounted to more or less than $15,000, then the purchase price was deemed to be diminished or increased accordingly. The parties treated these as purchase payments and no interest was payable on the amounts outstanding. The court accepted this interpretation of the contract and held the payments to be on account of capital. In deciding for the taxpayer, Romer J. ruled in effect that if a man has property he wishes to sell on terms which will result in his receiving for the next 20 years an annual sum of $500, he can do it in either of two ways. He may sell his property in consideration of a payment by the purchaser to him of an annuity of $500 for the next 20 years or he can sell the property for $10,000 to be paid in equal installments of $500 over the next 20 years. If he adopts the first method the annual payments are taxable income, but under the second

method he will be deemed to have received a payment on account of capital. In any case the question of which method was chosen is a matter of the proper construction of the transferring instrument.

It is abundantly clear that the result and substance of the transactions are the same in both cases, a fact which the court recognized, but in spite of this the taxpayer is left free to draw his contract in such a manner that receipts from the sale of property will take the form of instalments on purchase price rather than a series of annuity payments.

Annuity payments received under conventional forms of insurance are specifically dealt with in the Act which provides in s. 6(a)(iii):

> There shall be included in income . . . annuity payments.

Section 11(1)(i) provides:

> The following amounts may be deducted in computing income . . . the capital element of each annuity payment included in computing income for the year, that is . . . an amount equal to that part of the payment determined in prescribed manner to be a return of capital.

These sections in effect correspond to the 3% rule of the United States Internal Revenue Code, but it would appear that under the Canadian Act the government has wider discretionary powers in determining what portion of the payment received is to be treated as taxable income.

Another Triumph of Form

Another facet of the same problem arises in the case of a sale of a product of personal exertion. Here again we see an attempt to distinguish derivations from an unimpaired source and recurring payments for personal service on the one hand and a complete sale of an asset (i.e. recovery of capital) on the other. As a general principle, it may be stated, the mere fact that a payment is in a lump sum does not make it a capital payment. The payment may be in advance or at the end of a series of due dates. In some instances such payments have been referred to as "commuted royalties". Thus, a payment of wages in a lump sum does not alone change the nature of the receipt.

Illustrative of this proposition is the case of *Withers* v. *Nethersole* (1948), 1 All E.R. 400. The taxpayer, an author no longer engaged in writing, assigned for a fixed period a portion of her copyright interest in a novel in return for a specified payment. Such a transaction is susceptible to two interpretations. It may be argued that since she still owned the copyright in the words, what she received was rent for use. At the end of the period of assignment she received the original property intact, i.e. the exclusive right to reproduce the novel. An alternative view is that she did not receive back the same asset, for it had been impaired. It may well be argued that at the end of the period of assignment the author received back something less than what had been assigned, and the payment was for that part of the asset consumed through publication by the assignee. The Crown took the position that this payment was rent while the taxpayer contended it was a capital realization. The opinion represents another triumph of form over substance. By drawing a distinction between an assignment and a licence the court was able to find this to be a payment on account of capital. Under the rele-

vant copyright statute a licence transfers the right to use, while an assignment conveys a proprietary interest to the assignee. The practical effect in either case is the same except as to matters of procedure in infringement suits when the distinction becomes important in determining who is the aggrieved party.

While this narrow issue has been settled in Canada by s. 72 of the Income Tax Act which requires that receipts from an assignment of the copyright be treated as income, the taxpayer being allowed to distribute the amount over one, two, or three years depending on the length of time during which he was engaged in the production of the work, the larger problem remains with us.

As developed in the courts of England and Canada during the past one hundred years, the judicial concept of income, in theory, includes no element of capital gain or appreciation.

Rules of "Capitalization"

Taxpayers seeking to escape the taxation net by presenting their business activities under the guise of capital transactions are currently being advised to establish their position by the following conduct:

1. Do not make a profit on purpose — let it occur as an accident.
2. Aim at reducing the profit-taking operation to one transaction.
3. Avoid a complicated transaction which may be construed as the carrying on of a trade or business.
4. At the time of acquisition avoid any overt action from which the courts may find an intent to turn the asset over at a profit.
5. In selecting an asset designed for future resale at a profit, favour those which also produce income in order that the principal may be identified as an "investment".
6. When disposing of the asset at a later date, avoid any appearance that the motivation for the sale is profit alone.
7. Do not have associates to the scheme if the transaction can be completed by one person.
8. Hold the asset as long as possible.

As one eminent authority on income tax law expresses it, the capital gain must not be openly pursued else it will vanish. By these standards a capital gain (or to be more accurate, a gain not in the nature of taxable income) is the net proceeds of a realization on a capital asset, and income is the gain made in carrying out a scheme of profit making or in the operation of a business. A typical capital receipt is usually an isolated payment from a source which is impaired, while income is considered to be a recurring payment from an unimpaired source. Lord Justice Farwell[1] in considering the nature of income gave judicial recognition to a definition of income as understood by the economist Marshall and concluded that profit for a year from a business was the excess of receipts over outlays, the difference between the value at the end and at the beginning of the year being taken as a part of receipts or part of outlay according as there has been an increase or a decrease in value. However, in view of the judicial distinction drawn between fixed and circulating capital, such a statement does not represent the modern Canadian concept of income for tax purposes. In so far as net receipts are derived from "capital" transactions,

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[1] *Bond* v. *Barrow Steel Co.* (1902) 1 Ch. 353.

they are treated not as taxable income but as a nontaxable increment.

Costs of Capital Replacement

Lurking in this concept of capital gains and income is an unsophisticated notion that income may be gathered in without the impairment of capital.

Such a conclusion may be easily explained in the light of everyday experience. To the farmer, his capital is his horse and plough; to the fisherman, it is his boat and net. At the end of the season the farmer weighs his crop and the fisherman reckons up his catch. To each, the total measure constitutes income. The horse and plough, the boat and the net remain intact — or almost. It is true that these capital items will some day have to be replaced, but to many people the cost of a capital replacement is not associated with the periodic income received during the life of the asset, the reason, of course, being that the annual cost of these assets is often so difficult to measure that it escapes recognition.

Modern business, however, demands a more accurate treatment of costs than that just described. The cost of machinery and equipment, research programs, advertising campaigns and so on must be recognized and assigned to revenues in an orderly manner if any semblance of control is to be achieved. Modern accounting concepts of income determination, based on the principle of matching revenue with the costs of producing that revenue, have acknowledged the homogeneity of *all* assets, or more accurately, all costs. Fixed assets and deferred charges are accounts of definition only and may be transferred into current assets (or circulating capital to use the judicial term) by the mere lengthening of the period selected for income measurements. *Capital costs are distinguishable from current costs only by the number of periods during which they contribute to the earning of revenue.* If such is the case, it would appear unreasonable to differentiate between receipts to the extent of allowing so-called capital gains to escape an equal burden of taxation.

Income tax laws developed before the cost concept was fully appreciated and the courts in interpreting the word income can hardly be blamed if they restricted its meaning to that commonly understood at the time. No doubt the traditional position of the judiciary as the guardian of the subject against arbitrary taxation by a government acting without Parliamentary authority has also been an important confining influence.

Who Deserves Preference?

In a rapidly changing world, Canada cannot afford the luxury of a protracted philosophical discussion on the inviolability of the present tax-free capital gain. The modern argument in support of the current exemption appears to be founded on the assumption that the trader who buys and sells in an isolated transaction deserves preferential treatment as compared with that which is accorded to taxpayers in general.

The alarming consequence of this rule is found in the anomalous positions of the producer and the speculator. Buy an asset, improve it by adding material, labour and skill and then dispose of it at a profit, and you will surely attract an income tax. On the other hand, buy the same asset, do nothing more than hold it for a

rise in prices and you have made substantial progress in the direction of tax-free accretion. The issue is not whether the general burden of taxes should be increased by imposing a new levy on profits now going free to the citizen, but whether the present burden of taxes is being applied in a manner calculated to minimize this deterrent upon the activities of the man who produces for the benefit of the community.

Tax Exemptions Affect the Economy

The individual who buys and sells, whether it be securities, real property or any other commodity which lends itself readily to speculative profit, must have his present exemption weighed against the needs of the productive community. General prosperity depends not on the activities of the speculator taking isolated profits where he is able, but upon organized industry and commerce where the present need for tax relief is obvious. If tax concessions are to be used as a vehicle for directing the national economy, there appears to be a manifest virtue in offering those concessions where the effect is direct and the results will be susceptible to an accurate measurement. To be more specific: perhaps the proceeds from a wider tax might be directed to encourage more extensive use of machinery by permitting capital cost allowances to be based on present values and not on historic costs.

In this day of automation there is developing a pressing need for more skilled workers. Why should we not move to meet that demand by allowing a substantial concession to the taxpayer who spends money on the training of these skilled persons? Similarly, the advance of new skills and methods can be accelerated substantially by more generous allowances for expenditures on scientific research and development, especially among smaller businesses.

As a concluding argument *William v. Davis* (1945), 1 All E.R. 304 is an excellent example of the incongruous results which often flow from an attempt to distinguish capital gains and income. In this case the husband, a real estate dealer, on two occasions was able to purchase land at advantageous prices. Had he sold the land himself he would have attracted an income tax on the basis of the rule that his activity was in the nature of a trade, namely, the real estate business. At this point the husband made an outright gift[2] of the two pieces of land to his wife, who, in turn, promptly sold the properties at a substantial profit to a company controlled by the husband. The company, of course, would show little profit since it had purchased at the going market prices. On the facts it was found that the gifts were genuine and that the profits made by the wife *were not in the nature of trade or business and hence were not taxable income.*

The real inequity lies in the present exemption accorded so-called capital gains. In the final analysis, the result is to draw an artificial distinction between the reward accruing to the man who confines his activity to price speculation and the man who embarks on a productive undertaking[3].

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[2] This is an English case. In Canada secs. 100 to 104 of the ITA impose a tax on the donor at a graduated rate.

[3] Willis, John "Cases and Comments". *Canadian Bar Review*, 1949, p. 89.

The Anaconda Decision from the Accounting Viewpoint

G. G. RICHARDSON

THE DECISION of the Privy Council in the *Anaconda* case has been very ably analyzed from the legal point of view by Stuart D. Thom in the January-February issue of *The Canadian Tax Journal,* and by Melville Pierce in the current issue of this magazine.

From the accounting standpoint the *Anaconda* decision is in striking contrast with the views of accountants and economists as well as with the conclusions reached by the U.K. Royal Commission on the Taxation of Profits and Income under the chairmanship of Lord Ratcliffe, a distinguished jurist who is one of the law lords of the Privy Council. The following statements indicate something of the conflict between legal and accounting concepts in determining income insofar as the inventory problem is concerned.

The Privy Council Statement

"The income tax law of Canada as of the United Kingdom is built upon the foundations described by Lord Clyde in *Whimster and Co.* v. *C.I.R.,* 12 T.C. 813 in a passage cited by the Chief Justice which may be here repeated. 'In the first place, the profits of any particular year or accounting period must be taken to consist of the difference between the receipts from the trade or business during such year or accounting period and the expenditure laid out to earn those receipts. In the second place the account of profit and loss to be made up for the ascertaining that difference must be framed consistently with ordinary principles of commercial ac-accounting so far as applicable and in conformity with the rules of the Income Tax Act or of that Act as modified by the provisions and Schedules of the Acts regulating Excess Profits duty as the case may be. For example, the ordinary principles of commercial accounting require that in the profit and loss account of a merchant's or manufacturer's business the values of the stock-in-trade at the beginning and at the end of the period covered by the account should be entered at cost or market price whichever is the lower, although there is nothing about this in the taxing statutes.' For many years before and ever since this decision what is to be valued at the beginning and end of the accounting period has for tax purposes been taken to be the actual stock so far as it can be ascertained. It is in fact, so far as tax law is concerned, a novel and even re-

volutionary proposal that the physical facts should even where they can wholly or partly be ascertained be disregarded for the purpose of the opening and closing inventory and a theoretical assumption made which is based on a supposed "flow of cost" and an "unabsorbed residue of cost"

Later in the judgment the following statement is made:

"There is no room for theories as to flow of costs: nor is it legitimate to regard the closing inventory as an unabsorbed residue of cost rather than as a concrete stock of metals awaiting the day of process".

The A.I.A. Bulletin on Inventories

The Committee bulletin on inventories (originally issued as Bulletin No. 29 and reissued as part of Bulletin No. 43 in substantially the same language,) includes the following:

"Statement 2 — A major objective of accounting for inventories is the proper determination of income through the process of matching appropriate costs against revenues".

In the discussion which follows, this statement appears:

"In accounting for the goods in the inventory at any point of time, the major objective is the matching of appropriate costs against revenues in order that there may be a proper determination of the realized income. Thus, the inventory at any given date is in effect a residual amount remaining after the matching of absorbed costs with concurrent revenues. This residual is appropriately carried to future periods provided it does not exceed an amount properly chargeable against the revenues expected to be obtained from ultimate disposition of the goods carried forward. In practice, this residual amount is determined by the process of pricing the articles comprising the inventory".

The discussion under statement 4 includes the following:

"The cost to be matched against revenue from a sale may not be the identified cost of the specific item which is sold, especially in cases in which similar goods are purchased at different times and at different prices. Ordinarily, under those circumstances, the identity of goods is lost between the time of acquisition and the time of sale. In any event, if the materials purchased in various lots are identical and interchangeable, the use of identified cost of the various lots may not produce the most useful financial statements. This fact has resulted in the development and general acceptance of several assumptions with respect to the flow of cost factors to provide practical bases for the measurement of periodic income. These methods recognize the variations which exist in the relationships of costs to sales prices under different economic conditions. Thus, where sales prices are promptly influenced by changes in reproductive costs, an assumption of the *last-in first-out* flow of cost factors may be the more appropriate. Where no such cost-price relationship exists, the *first-in first-out* or an "average" method may be more properly utilized. In other situations a reversed mark-up procedure of inventory pricing, such as the retail inventory method, may be both practical and appropriate."

G. O. May Statement

In discussing the report of the Royal Commission on the Taxation of Profits and Income (*The Accountant*, December 24, 1955), Mr. May makes the following statement relating to the recommendation of the

Commission that a modified form of *Lifo* be allowed:

"In dealing with matters of this kind there have to be considered an objective, a set of facts and a method which, when applied to those facts, will achieve the objective. As the majority has pointed out, what is the prime requisite is not to value the inventories, but to measure the proper charge in respect to the consumption or disposition of inventoriable goods; and the same holds true with regard to the charge for exhaustion.

"For either purpose a fiction may be a more acceptable basis than a purely factual one. The minority says that if the cost of the identical goods sold could be determined, 'these costs would form the sole permissible deduction from receipts'. But in America the opposite view is held; the identification method is rejected in the case of fungible goods because of the obvious opportunity for manipulation of profits that it affords. This is a case in which a fiction is a better guide than a fact, *Lifo* and *Fifo* are both fictions".

Royal Commission Report

Chapter 18 of the report dealing with accounting for "Stock and the Computation of Profits" has already been reproduced in the February issue of this journal but it may be worth reproducing a few of the statements therein.

"The general assumption hitherto accepted in this country is that stock is sold in the same order of priority as the order of the dates at which it was acquired. . . ."

"We do not suppose that this assumption, however convenient, derives its validity from any perculiar correspondence with the trader's physical operations. Strictly speaking, it assumes an order that is likely to be observed only in the case of perishable goods. . . ."

"This led us to ask, however, whether there is anything in the tax code or any governing principle of taxation that requires the adoption of *Fifo* by all traders, even at a time when its employment produces such unwelcome results.

"There is nothing in the tax code itself that prescribes any rules for ascertaining the basis of cost or for *valuing* stock in trade. The presumption is that such rules are to be extracted from trade practice and the principles of commercial accountancy. Nor do legal decisions in the Courts appear to have built up any body of doctrine even if it had been proper for them to supply rules upon a subject that seems eminently one of sound commercial practice. The most that legal authority can be said to have required in this connection is that, in estimating profits for tax assessment, the figure taken for the cost of articles sold must represent a real attempt to arrive at their cost and must not be fixed by reference to some arbitrary or fictitious standard, such as is involved in some forms, at any rate, of what is known as the *base stock* method. But even so this requirement has no bearing on the question whether there is any particular sanctity in the *Fifo* method if other methods, which seem better adapted to the circumstances of a business or the commercial conditions of the day, are or come to be recognized by the trading community and professional accountants. . . ."

"For the case put to us on the part of the Board is that, in effect, *Fifo* is the only permissible method for the

purpose of tax assessment. No doubt such a claim would not be supposed to admit of no qualifications, since, for instance, it is obviously inapplicable to those businesses in which the items of stock are capable of specific identification. But, generally speaking, it is claimed that *Fifo* ought to be treated as if its adoption were a statutory obligation of all taxpayers in the computation of their business profits. This seems to us a very large claim, having regard to the variety and complication of the business activities to which it would be applied . . ."

The Economist Editorial

The following editorial appeared in *The Economist* in its issue of December 17, 1955:

"The iconoclasm of the House of Lords in the *Gourley* case (which dealt with assessment of damages for loss of earnings) is in direct contrast with the conservatism of the decision of the Judicial Committee of the Privy Council in *Minister of National Revenue* v. *Anaconda American Brass Ltd.* This important appeal was against the finding of the Canadian Supreme Court that trading stock might properly, for taxation as well as for other purposes, be valued on the *Lifo* — last in, first out — basis. The Judicial Committee allowed the appeal: in the legal arena *Lifo* has taken the count, and its rival, *Fifo* — first in first out — is in command of the ring.

"The problem of stock 'valuation'" has been extensively rehearsed in recent years: it is recognized that it is not really a 'valuation' of the stock unsold, but an accounting device which is necessary in order to arrive at the true costs of the stocks that have actually been sold during the trading period. The Revenue authorities in this country have always held that *Fifo* alone achieves this result, and were supported as recently as 1953 by the Court of Appeal in the *Broadstone Mills* case. The Royal Commission, however, regarded the Revenue's view as a 'very large claim': the tax code, it held, laid down no rules for 'valuing' stocks; *Fifo* had no special sanctity, being itself no more than an estimate, and other methods could be and are used with equal propriety for ascertaining commercial profits. The Commission recommended, therefore, that different businesses should be free, with suitable safeguards, to adopt the method which best suited their particular commercial needs.

"The conditions which justify the adoption of *Lifo* as a proper and generally accepted method of accountancy were conspicuously present in the *Anaconda* case, and the decision of the Judicial Committee had been awaited in the hope that it might lead to some rapprochement between the fiscal and the commercial concept of profit . That hope, short of legislation, now seems to have gone. and the time has therefore come for Parliament to take a hand. 'Profit' is a much abused word which has already far too many different meanings. But when Finance Acts charge 'profits', the charge ought to be on profits computed in accordance with sound and accepted commercial and accounting principles. No question of avoiding tax comes into the argument at all; *Lifo* can cut both ways, beneficial on occasion, and prejudicial on other occasions. But there would be much practical relief, and no critical danger to the revenue, in a system that gives words their practical meaning and does not promote schismatic definitions."

On the Subject of Hidden Reserves

The U.K. Royal Commission on the Taxation of Profits and Income considered that the *Lifo* method did not create a reserve unless one assumed that there was some inherent validity in the *Fifo* method, a proposition which it was not prepared to accept.

The Privy Council thought otherwise but for some reason rejection by the Courts of an accepted accounting principle as not resulting in the determination of "true profits" is frequently accompanied by a laudatory statement that it is an appropriate method for arriving at profits for purposes other than taxation, or where the rights of third parties are not affected. (Apparently the same yardstick need not be applied to statements to shareholders regardless of the importance of decisions which they have to make as to selling or holding their stock).

In the *Anaconda* case the court said:

"Their Lordships do not question that the *Lifo* method or some variant of it may be appropriate for the corporate purposes of a trading company. Businessmen and their accountant advisers must have in mind not only the fiscal year with which alone the Minister is concerned. It may well be prudent for them to carry in their books stock valued at a figure which represents neither market value nor its actual cost but the lower cost at which similar stock was bought long ago. *A hidden reserve is thus created which may be of use in future years.*" (*Italics supplied*)

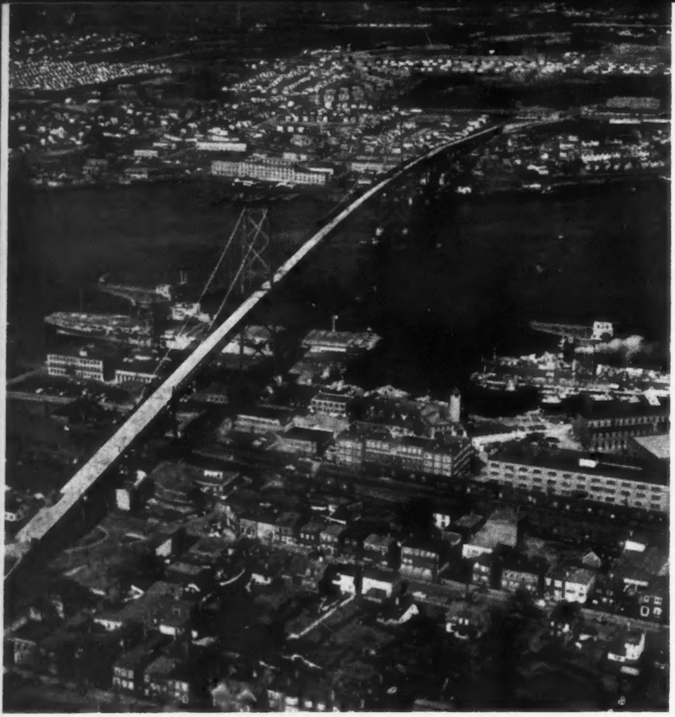
This statement came 25 years too late to assist the officials of the Royal Mail Steam Packet Company in the classic case relating to hidden reserves.

American Management Association Seminar

The first group of educational meetings for business executives ever to be conducted outside the United States by the American Management Association will be held in Toronto between April 23 and 27. These seminars have been scheduled to give industrial leaders of Canada an opportunity to participate in an international educational program that is within convenient reach of their local operations.

Two types of seminars will be conducted, workshop and orientation. Workshop seminars are made up of groups of 15 or fewer executives who meet for three full days under the guidance of one or more discussion leaders to exchange knowledge and experience in a particular area of management thought and practice. Orientation seminars are somewhat larger meetings conducted in classroom style for review of or instruction in a management specialty.

The orientation seminars scheduled will deal with electronic data processing, administration of the maintenance function and the function of marketing research in industry. The ten workshop seminars will provide discussion on the functions of the financial executive, the accounting function, production planning and control, operation of the branch plant, the credit function, purchasing, the field sales force, organization of the chief sales executive's job, executive selection, and negotiating the union contract.



DATE:

PLACE:

EVENT:

THEME:

PLANS ARE ALREADY underway for this year's annual conference, and C.I.C.A. visitors to Halifax can look forward to a technical and social program as attractive as those in Winnipeg and Toronto.

Our host Province this year is Nova Scotia — "the beginning of America". Her farmlands date back to 1605 and Port Royal Habitation was the first permanent settlement north of the Gulf of Mexico. Today more than a thousand miles of her highways are within sight of the sea, and yachts, large and small, ride the waters of every bay. Two hundred year old Halifax, the venerable, grey capital of the Province with a steadily mounting population of over 100,000, overlooks one of the world's finest harbours. Most recent achievement of the Province's development program is the Angus L. Macdonald Bridge which joins Halifax with Dartmouth and was named in honour of the late Premier of Nova Scotia.

The Annapolis Valley has the largest aggregation of apple orchards within the British Commonwealth and after mid-summer the trees are heavy laden with fruit. Visitors will find great interest in the Cabot Trail, the most spectacular 185 mile drive in Eastern Canada and C.I.C.A. members who love the sea will want to linger along Nova Scotia's South Shore. Those who are interested in the past will find themselves in the very heart of history. From 1613 to 1815 the Province was a land of soldiers and warfare. Fighting for Nova Scotia itself lasted a century and a half and every county has its old forts and historic battlegrounds.

The social and business sessions of the Conference will be held at the Nova Scotian Hotel situated on the waterfront and the Lord Nelson Hotel that overlooks Halifax's famous Public Gardens.

September 10, 11, 12, 1956

Halifax, Nova Scotia

1956 C.I.C.A. Annual Conference

"Widening Horizons for the Chartered Accountant"

The three "keynote" addresses, setting the theme for the conference, will be presented on Monday morning, September 10, by C.I.C.A. President, Gerald Martin, by a member in practice and a member in industry. At the members' luncheon on the same day the guest speaker will be the Honourable Robert Winters, Federal Minister of Public Works. Technical sessions on Tuesday and Wednesday, September 11 and 12 will again feature papers with discussion periods, panel discussions and concurrent group discussions.

The various committees for the conference are programming an excellent series of activities for members and guests. Among special functions are an opening reception at the Nova Scotian Hotel, an At Home aboard a Royal Canadian Naval vessel and a bus tour to scenic Peggy's Cove and on to Hubbards, a holiday resort with good beaches, for a lobster boil followed by a square dance. Further details about the technical program and other events will be mailed to members early next month.

Special functions for the ladies are also being planned. A 15 mile bus drive and coffee party on the opening day and a coffee party at the Nova Scotia president's home on Tuesday, September 11. A highlight for Wednesday is a morning reception at Government House, one of the oldest executive mansions in North America, built nearly 150 years ago. This will be followed by a luncheon at the Lord Nelson Hotel.

It is not too early for C.I.C.A. members to make their plans with respect to the annual conference. Every endeavour is being made to schedule an attractive list of topics for the various technical sessions while at the same time seeing that visitors to Nova Scotia carry away with them a harvest of pleasant memories.

L'expert-comptable - homme de profession libérale?

FRERE CLEMENT LOCKQUELL

Les hommes qui exercent un même métier ou s'adonnent à une occupation de même nature sont, d'instinct, inclinés à se grouper en association légale. C'est un droit naturel que le contexte social semble de plus en plus favoriser. Une autre inclination caractérise les hommes exerçant des occupations semblables non manuelles: ils réclament le titre de professionnels. Je désire examiner brièvement quelles sont les composantes du concept de profession libérale, et me demander si l'expert-comptable peut prétendre au titre de professionnel.

Une méthode rigoureuse m'imposerait de définir d'abord des termes plus ou moins connexes, tels que: profession, métier, occupation, classe, et d'autres dont ils sont plus ou moins inclusifs, tels que salaires, revenus etc. Je me contenterai de proposer un sens approximatif aux termes classe et profession. La plupart admettent que les catégories sociales que l'on appelle classes, telles qu'elles existent dans notre histoire contemporaine, constituent une hiérarchie selon laquelle les hommes sont appelés à participer consciemment et légalement à la vie collective sous des formes de plus en plus appréciées de la société. Autrement dit, les classes se distinguent d'après la dignité humaine qu'elles permettent à leurs membres respectifs et d'après la fonction politique qu'ils exercent. L'aspect économique du problème n'est ni négligeable ni secondaire, affirment les sociologues.

Caractéristiques de la profession

Quant à la profession, elle partage avec la notion de classe cette marque, à savoir: que plus elle est libérale, plus elle apporte de considération sociale à ceux qui en font partie. Si nous examinons, dans la perspective commune, et pour ainsi dire populaire, ce qui sépare le professionnel du non professionnel, nous sommes d'abord confrontés à trois grandes caractéristiques. D'abord, l'activité professionnelle semble exclusivement intellectuelle (ainsi se fait jour le vieux préjugé contre le travail manuel considéré comme exclusivement servile). Une deuxième qualité du professionnel, c'est qu'il jouit apparemment de l'indépendance, qu'il possède un droit d'initiative, qu'il n'obéit pas à un autre, au moins dans l'exercice propre de ses fonctions, qu'il n'est pas astreint à une discipline extérieure. Enfin, on

admet qu'un homme de profession exerce une activité désintéressée, qu'il n'a pas pour objet une activité productrice au sens étroit où Saint-Simon et Marx entendaient ce mot. L'homme de profession ne doit pas être un homme de commerce.

En gros, la profession évoque l'idée d'une activité privilégiée, supposant une instruction plus ou moins coûteuse, l'éducation que prétend dispenser la bourgeoisie moyenne, des relations influentes, un certain capital. On remarque également chez les professionnels une conscience de caste, une intention de vivre en un monde clos, l'orgueil d'appartenir à un "ordre" dont sont farouchement exclus ceux qui ne peuvent garantir l'ensemble des qualités ci-haut énumérées.

La profession classique

D'après ce barême, il semble bien que soient justifiées les prétentions des professionnels-types, c'est-à-dire de ceux qui relèvent quant à leur formation académique des trois facultés des universités médiévales: théologie, droit et médicine. Le type le plus parfait du professionnel serait l'avocat dont l'activité serait la plus libérale. Viendraient ensuite le notaire et le médicin. (Nous n'examinerons pas la situation très spéciale du ministre du culte.)

Il n'apparaît pas moins évident que dans notre contexte social contemporain, l'exclusivisme de cette classification satisfait de moins en moins l'idée que nous sommes amenés à nous construire du professionnel. Nous pourrions d'abord affirmer qu'un professionnel doit s'estimer non pas tellement d'après le niveau qu'il atteint grâce à d'anciennes lettres de créance, que par la poussée qui le dirige et l'oriente vers l'utilité du client.

Ainsi, ce n'est pas la seule condition sociale même éminente qui consacre un homme professionnel. Par exemple, il peut arriver qu'un grand politique n'exerce pas une activité vraiment professionnelle. Le caractère intellectuel de l'occupation n'est-il pas davantage essentiel? La plupart des artistes et des écrivains s'ajustent mal à cette étiquette. Le type d'organisation professionnelle est également insuffisant. Il y a certains fonctionnaires qui peuvent être nommés professionnels, exemple, les instituteurs, tandis qu'un genre d'occupation organisé sur le type classiquement libéral ne fait pas de ses membres de vrais professionnels, exemple: l'ordre des pharmaciens, la catégorie des médecins de laboratoire, certains chirurgiens très spécialisés . . . .

Le don de conseil

Il semble donc qu'il faille élargir les frontières de la profession libérale. Nous pourrions partir d'une définition qui, pour n'être pas complète, permet cependant de cerner l'essentiel de la profession.

> *"Profession" — "a vocation in which a professed knowledge of some department of learning or science is used in its application to the affairs of other men considered individually and personally contacted or in the practice of an art founded upon it."*

"The affairs of others" semble un élément important de cette définition. Autrement dit, le professionnel est un homme qui s'inquiète du client. D'autre part, les relations entre le practicien libéral et celui qui le consulte doivent s'établir directement sur le plan humain. Il s'agit d'affaires personnelles plus qu'économ-

iques (ce qui n'empêche pas les considérations d'argent d'entrer en ligne de compte). Néanmoins, il s'agit d'abord d'intérêts intimes qui ne sont pas toujours nécessairement considérables, mais qui ne peuvent être envisagés, défendus ou améliorés que par le conseil. Le professionnel est un homme qui possède le don de conseil. De par son étymologie même, le terme professionnel indique bien la nature de son action. Il s'agit de proférer, c'est-à-dire de proposer par la parole une ligne de conduite. La parole du professionnel crée ou entretient chez son interlocuteur des valeurs morales. Elle s'adresse à l'intelligence et au sentiment du consultant et dans la mesure où il n'y a pas d'opposition d'intérêts, il s'ensuit une activité vraiment libérale. L'indépendance du professionnel mesure la confiance du client.

Sous l'oeil plus ou moins méfiant des professionnels "patentés", certains groupements aspirent au statut de l'activité libérale. Parmi eux les experts-comptables. Il y a en France un *"ordre"* des comptables agréés (d'ailleurs assez discuté). L'Italie de la Renaissance a reconnu comme corps professionnel les experts-comptables qu'exigeait, entre autres, l'activité bancaire des Médicis et consorts. Mais les comptables sont à peu près inconnus dans le monde anglo-saxon d'avant 1850. Au Canada, les associations comptables existent, mais il leur reste encore à se faire accepter en tant qu'organisations spécifiquement professionnelles. Leur désir de parvenir à ce statut est de plus en plus pressant. Cette ambition est-elle justifiée?

Pour clarifier le problème, il faudrait d'abord écarter comme présomptueux ceux que l'on pourrait nommer les manoeuvres de la comptabilité et qui illégitimement réclament plus ou moins ouvertement d'être identifiés aux comptables agréés (le jour semble encore loin ou toute équivoque sera rendu impossible). Quant au comptable agréé, satisfait-il aux exigences de la profession libérale? Je pense qu'il est inutile d'insister sur le fait que l'activité comptable n'en est pas une de production, qu'elle n'est pas manuelle et qu'elle use comme d'un instrument essentiel et principal du langage oral ou écrit. Cette première condition de la profession semble bien remplie. On ne saurait alléguer certaines occupations mécaniques considérées comme serviles: la plupart des professions classiquement libérales connaissent ces espèces de servitudes, le médicin use d'instruments et le notaire emploie des formules toutes faites.

Comptabilité et casuistique

Intellectuellement, les experts-comptables offrent de suffisantes garanties. Leurs rangs se grossissent de plus en plus de jeunes gens à formation universitaire et, à l'usage, le public finit par distinguer le comptable agréé dont la culture est vraiment supérieure du comptable agréé dont l'instruction est réduite à un minimum de recettes pratiques. L'expert-comptable qui a suivi régulièrement le curriculum universitaire est ordinairement mieux apprécié et plus utilisé que le comptable agréé autodidacte. (Il reste que beaucoup de tâches comptables sont infra-universitaires, et que nombre d'entreprises préfèrent, pour des raisons budgétaires, employer des manoeuvres pour les remplir.)

Un homme de profession est un homme qui n'abandonne jamais la

recherche. Cette recherche ne se limite pas à l'étude de documents livresques: elle se poursuit par l'examen de cas particulieurs. La fonction d'expert-comptable comporte une application continue à des cas d'espèces et, en ce sens, elle réclame un esprit de finesse capable d'apprécier les contingencies et leur subtilité, sens qui échappe trop souvent à ceux dont un entraînement trop technique n'a développé que l'esprit de géométrie. Il y a une casuistique de la comptabilité comme il y en a une de la médecine et de la jurisprudence.

L'expert-comptable exerce une activité spécifiquement professionnelle lorsque, ne se contentant pas de scruter un état financier anonyme, il analyse, en face de son client, les circonstances de temps, de lieu, de personnes, en un mot, toutes les causes qui ont contribué à déterminer cet état financier. Il juge vraiment de situations de fait dans toute leur complexité. Il ne se cantonne pas dans les opérations exclusivement mathématiques. Pour lui comme pour le statisticien, les nombres recouvrent des réalités. Ils sont les signes d'intentions, d'actions, de motivations personnelles. Ses connaissances théoriques se terminent à une activité pratique. De sorte qu'on pourrait parler d'un art comptable tout comme on parle d'un art médical.

Comptabilité et coordination

Le comptable agréé agit professionnellement dans des relations de personne à personne. Il se pourrait, par contre, qu'un administrateur qui ne travaille que sur des rapports établis par d'autres ne soit pas strictement un professionnel. Beaucoup d'occupations qui, à première vue, semblent éloignées de la profession peuvent paradoxalement exiger, aux moins en certaines circonstances, des dispositions professionnelles. Les conseils que dispense un assureur-vie, le choix que guide un libraire, l'enquête que mène un journaliste, l'examen que poursuit un officier de l'impôt, la psychologie que déploie un vendeur, même l'intuition et le goût dont doit faire preuve une décoratrice d'intérieur . . . toutes ces activités sont au moins provisoirement professionnelles.

A plus forte raison, semble-t-il, mériterait le titre d'homme de profession, le comptable agréé qui doit connaître de choses et de personnes variées, situées à des degrés divers de l'échelle des valeurs. De plus en plus, l'expert-comptable se doit d'être un honnête homme. Ce que Cicéron exigeait de l'orateur, c'est-à-dire de l'avocat de son temps, le monde contemporain l'attend de celui qui compte les pulsations de l'activité humaine dans le secteur économique, domaine qui, instrumentalement au moins, conditionne tous les autres.

On sait d'ailleurs que de plus en plus, l'expert-comptable est appelé à siéger à l'intérieur de comités et de conseils d'administration. Là, il joue le rôle de conseiller, d'agent de planification. Prévisions et contrôle sont des opérations éminemment intellectuelles. Une autre qualité du comptable agréé qui lui donne droit au titre de professionnel c'est qu'il ne vend pas une marchandise. En principe, il est désintéressé à l'égard de son client. Il rend un service et même si ce service est rémunéré comme il se doit, il n'est pas appréciable rigoureusement selon une échelle stable de prix. Ce service est compensé par des honoraires. Il n'est pas acheté. L'échange qui s'établit

entre l'expert et son client n'est pas un échange commercial, mais un échange moral.

Une preuve indirecte que le comptable agréé offre un service vraiment personnel peut se trouver dans la confiance que provoque tel bureau plutôt que tel autre, et à l'intérieur d'une même étude comptable, l'attirance qu'exerce tel individu plutôt que tel autre. Ainsi, les valeurs étant humaines, elles ne sont pas interchangeables.

Les considérations précédentes ne répondent pas adéquatement à la question: les experts-comptables peuvent-ils être considérés comme exerçant une activité proprement libérale? Nous pouvons cependant remarquer qu'à l'intérieur de leur association, une conscience professionnelle s'approfondit de jour en jour; que les standards exigés pour l'occupation des postes éminents de la carrière s'élèvent graduellement; que la notion de service s'accrédite; que la participation des comptables agréés à l'établissement ou à la conservation du bien commun augmente et provoque plus de respect. Il n'empêche que l'expert-comptable n'a pas encore imposé aux intellectuels le prestige auquel il aspire légitimement. Il reste beaucoup de préjugés à vaincre. Jusqu'ici, l'ignorance ou l'indifférence du public relativement au rôle social de l'expert-comptable semblent entretenues par ceux qui possèdent béatement des titres séculaires, qui exercent des fonctions cataloguées. Mais sans invoquer la théorie marxiste de l'histoire, ne peut-on pas prévoir une époque de l'administrateur et du vérificateur? Ou encore, si l'on croit au retour cyclique de l'histoire, ne pourrait-on pas voir poindre à l'horizon une époque semblable à celle où régnaient les grands commis de l'Europe continentale des dix-septième et dix-huitième siècles?

Mais il ne faut pas attendre ce nouvel état de choses du seul déploiement fatal des forces historiques. Ce sont les hommes qui composent, qui construisent le contexte social de demain. Et il semble bien que l'expert dans la science et l'art de la comptabilité prise dans son sens le plus largement humaniste, doive y jouer un rôle de premier plan.

BY GERTRUDE MULCAHY B.A., C.A.

Accounting Research

The C.I.C.A. Research Department

SHAREHOLDERS' EQUITY – CONT'D

This is the third in a series analyzing the expression of shareholders' equity in published financial statements. The first instalment (February, 1956) considered the form of presentation and the terminology of the caption of this section. The second, appearing last month, dealt with the terminology used by Canadian accountants to describe the elements of corporate surplus and other miscellaneous items forming part of the shareholders' equity.

Clear expression of financial information requires not only adequate descriptions but also proper classification. Therefore, this discussion would be incomplete without an evaluation of the effectiveness of the current classification techniques. Some general observations on the methods employed to identify the amount of the owners' interest and to distinguish the various elements thereof were included previously in this analysis under the heading "Form of Presentation" (*The Canadian Chartered Accountant*, February 1956, page 127).

Classification Within Corporate Surplus

Proper classification calls for the systematic grouping of financial data on the basis of some common characteristic or feature. Within the corporate surplus, this common characteristic is source. Realized surplus has only two sources: contributions and earnings, and there is a basic difference between the amounts derived from each of these. Adequate expression, therefore, requires that the classification of surplus items distinguishes between the two sources of realized surplus and recognizes similarities of source. The Committee on Accounting and Auditing Research suggested in Bulletin No. 11 that this can be accomplished very simply but effectively by the segregation of surplus items into two main categories: "earned surplus" and "contributed surplus".

If corporate surplus is made up of only one figure representing an unrestricted balance of amounts earned during the course of business, there is no particular problem. Its actual source can be clearly identified in the wording of the descriptive designation. However, in 1954, 128 of the 275 survey balance sheets showed miscellaneous surplus balances in addition to accumulated earnings or deficit. (See Table 26(a) of "Financial Reporting in Canada.") Last month's discussion pointed out that these items represented amounts derived from both earnings and contributions. Unfortunately, in most cases the form of presentation failed to achieve what could be considered adequate expression. Little or no effort was made to provide proper classification according to the standards outlined above.

Some of the balance sheets showed the various surplus balances as independent separate figures, thereby

implying that there is no similarity between them. When corporate surplus is represented by two balances, each derived from a different source, there is some justification in this form of presentation. On the other hand, where more than one of the surplus items arise from a similar source, this independent extension may suggest a dissimilarity which, in effect, does not exist.

Other balance sheets did provide some grouping of the elements of corporate surplus. However, in most cases, this grouping was made to distinguish the various items on the basis of similar terminology in their designations. In other words, the presentation differentiated between balances described as capital surpluses, distributable surplus, tax paid undistributed surplus, reserves, earned surplus, etc. Since little or no consideration was given to the actual sources of the individual items, this form of presentation often resulted in the grouping of items derived from both earnings and contributions. It should not be misinterpreted as a recognition of similarity or dissimilarity in sources.

The clarity of expression which can be achieved by proper classification can perhaps be most easily illustrated by consideration of presentations which are deemed to be ineffective. For this purpose, I have selected three examples from the annual reports included in the 1954 survey of financial reporting.

The independent extension of the three surplus balances in example 1 fails to give recognition to the similarity in their sources. They are all, in effect, items of earned surplus and should be identified as such. The last two items reflect information concerning the availability of the company's surplus for distribution to the shareholders. The "Tax paid surplus" represents that portion of accumulated earnings which, as a result of the actions of management, can be distributed to the shareholders free of additional income taxes. The "Special surplus" indicates a restriction on the amount of earned surplus available for distribution as dividends. Under the terms of issue of the company's capital stock, the company must set apart each year, in a special surplus account, 10% of net profits after providing for depreciation and income taxes until $500,000 has been accumulated at which amount it must then be maintained. This segregation of earnings primarily provides protection for the Class "A" shareholders who are entitled to a cumulative annual dividend of $1.50 preferential over all other shareholders. As stated in Bulletin No. 11, the disclosure of information such as this should not distort the basic classification as to source. Adequate expression, in this case, could have been achieved very simply by the classification of these three items under the heading "Earned surplus".

The form of presentation of example 2 may be confusing. Why are the balances "Distributable Surplus" and "Earned Surplus" grouped? Is it intended to indicate that there is some correlation between these two items and a basic difference between both of them and the balance designated as 'Capital Surplus"? This would certainly not appear to be the case. "Distributable Surplus" is the statutory designation for that portion of the proceeds of the issue of shares without par value not allocated to

EXAMPLE 1

Capital stock and surplus:		
Capital stock outstanding*:		
	$1,363,790.00	$1,953,210.00
Earned surplus	2,148,363.79	1,721,197.86
Tax-paid surplus	8,713.67	8,713.67
Special surplus	500,000.00	500,000.00
	$4,020,867.46	$4,183,121.53

EXAMPLE 2

Capital Stock*		$363,400.00
Capital Surplus, arising from the redemption of preference shares		132,400.00
Distributable Surplus	$ 26,827.67	
Earned Surplus:		
Per statement attached	396,024.60	422,852.27

EXAMPLE 3

CAPITAL, RESERVES AND SURPLUS:			
Capital Stock*		$2,385,000	
Reserves and Surplus:			
Capital surplus arising from redemption of preferred shares		165,000	
Reserve against future decline in inventory values	$1,325,000		
Reserve for replacement of fixed assets	425,000		
Reserve for contingencies	150,000		
Surplus arising from appraisal of fixed assets in 1920	72,701		
Surplus arising from sales of fixed assets	41,909		
Excess of book value of subsidiary at date of acquisition over purchase price	83,958		
		2,098,568	
Earned surplus — as shown on attached statement		633,373	
			$5,281,941

* The details of the capital stock presented in the financial statement have been deleted for purposes of these examples.

share capital. It is therefore an item of "Contributed Surplus". "Earned Surplus", on the other hand, represents the accumulation of amounts earned in the conduct of business. Except for the fact that both of these balances are elements of corporate surplus, there is no similarity between them. However, legally they are both available for dividends; but this is true also of "Capital Surplus". In addition, the "Capital Surplus" bears a definite relationship to the "Earned Surplus". The former balance is merely a designation and segregation of earnings required by section 61 of the Companies Act (Canada) 1952. This allocation does not alter its essential character. It remains earned surplus but subject to such restrictions as were imposed by the conditions which dictated its segregation. The requirements of clear expression could have been met by the grouping of these two balances under the descriptive heading "Earned Surplus" and the classification of "Distributable Surplus" as an item of "Contributed Surplus".

Example 3 displays quite a variety of miscellaneous balances. Unfortunately, this form of expression falls far short of achieving clarity. Although the shareholders' equity is segregated into two sections, there is no sub-total for that portion designated as "Reserves and Surplus". The wording of this descriptive caption might be interpreted as an indication that reserves are not part of corporate surplus. Since reserves represent an appropriation of earnings, they are in effect an item of earned surplus. It is rather difficult to understand why six of the miscellaneous balances were grouped over the sub-total $2,098,568 while the other two surplus items were extended as separate figures. There does not appear to be any logical basis to this presentation and it tends to confuse rather than clarify the picture.

The deficiencies of this example could be remedied quite easily. The elements of shareholders' equity should be segregated into sub-sections: capital stock, surplus, and miscellaneous items with sub-total extended for each. Within the surplus portion, the following items should be classified under the heading "Earned Surplus": "Capital Surplus arising from redemption of preferred shares", (which is an appropriation of earned surplus under section 61 of the Companies Act (Canada)) "Surplus arising from sales of fixed assets" and "Earned Surplus — as shown per attached statement". In addition, the various reserves should be presented by sub-classification under this main heading. If the balance "Surplus arising from appraisal of fixed assets in 1920" represents an unrealized increase, it is not an element of corporate surplus. It should, therefore, be set out as a separate item in the shareholders' equity section and should be identified by some term other than surplus or reserve.

The correct classification and presentation of the balance "Excess of book value of subsidiary at date of acquisition over purchase price" depends upon the individual circumstances. It has been suggested that the excess credit should be shown as a deduction from a specific asset or assets in the consolidated statements if there is objective evidence of their overvaluation. In this respect, "Principles of Accounting — Advanced" by Finney and Miller includes the following comment:

"An adjustment of asset valuations is doubtless the procedure which would give the most and best information to the balance sheet reader, but it is a procedure usually difficult to apply because of an inability to obtain adjusted asset valuations supportable by objective data."

Some accountants believe that the excess credit should be shown as a deduction from the total consolidated assets if allocation cannot be made to specific assets of the subsidiary. Others, however, are of the opinion that it should be reflected as an item of the shareholders' equity. The former presentation may be based on the theory that the excess represents a provision for general overvaluation, estimated losses and shrinkage. The latter could be supported by the contention that the process of consolidation effects a restatement of assets which in turn involves an adjustment to the shareholders' interest therein. This, of course, leads to the question of classification within the shareholders' equity. Should the excess credit be set out as a separate item or as an element of surplus? If the latter were considered to be the more suitable, there would be further considerations. Is it an item of earned surplus or of contributed surplus?

The annual report from which example 3 was taken does not give any information relating to the actual purchase of the interest in the subsidiary. Hence it is impossible to say whether or not a clearer picture would have been presented if the excess credit had been set out either as a deduction from a specific asset or assets, or as a deduction from the total assets. If the present classification is in order, the balance "Excess of book value of subsidiary at date of acquisition over purchase price" should have been set out either as a separate figure within the surplus portion classified as to source or as an independent separate item of the shareholders' equity.

Classification of Miscellaneous Surplus Balance

Table 26(b) of "Financial Reporting in Canada", which was set out on page 227 of the March, 1956 issue of this journal, shows that in 1954 there was a total of 153 miscellaneous surplus balances exhibited in the survey balance sheets. Last month's discussion indicated that in the majority of cases the designating descriptions failed to provide information as to the source of these balances. The following résumé of the classification techniques used in the presentation of the various miscellaneous surplus balances indicates a similar deficiency. Consideration is also given to the procedures adopted to classify the reserves shown as part of the shareholders' equity.

Capital Surplus

Unfortunately, the classification techniques relating to the 71 balances set out under "Capital Surplus" in Table 26(b) of "Financial Reporting in Canada" were equally as ineffective as the terminology describing them. Neither provided information relating to the actual source or sources. In practically every case, the capital surplus was set out as a separate item or as a separate section of the shareholders' equity. This segregation was made on a basis of terminology rather than source.

In many cases, the details of the "Statement of Capital Surplus" or notes to the financial statements in-

dicated that the capital surplus figure included amounts derived from both sources of realized surplus. However, since the majority of these statements did not provide a breakdown of the items included in the opening balance, it was impossible to determine the total amount received from each source.

TAX PAID UNDISTRIBUTED INCOME

Only 2 of the 7 tax paid undistributed income balances could be considered to have been properly classified. In both cases, this item was included in a figure designated as "Earned Surplus". The qualification of this figure was expanded, on one of the balance sheets, as follows: "Earned Surplus (including $1,517,-043.54 tax-paid undistributed income)". In the other case, the amount of the tax paid undistributed income was set out in a separate sub-section of the "Statement of Earned Surplus". The total balance of this statement was carried in the balance sheet as "Earned Surplus". In 3 cases, the figures for tax paid undistributed income and for earned surplus were set out under the caption "Surplus". This presentation should not be misinterpreted as an indication of similarity in source. Its only purpose was to distinguish the surplus items from capital stock. In the 2 remaining balance sheets, all surplus items were set out as separate independent figures, thereby denying any similarity between them.

PURCHASE AND/OR REDEMPTION OF PREFERRED SHARES

Nineteen of the 29 balances so classified in Table 26(b) represented earned surplus appropriated as "Capital surplus" under section 61 of the Companies Act (Canada). However, only two of the balance sheets concerned recognized earned surplus as the source of the balance. In one case it was set out as a separate figure in the shareholders' equity described as "Capital surplus (transferred from earned surplus upon redemption of preferred shares)". In the other it was included under the caption "Capital stock" and described as "Earned Surplus – capitalized under the provision of section 61 of the Companies Act on the redemption of preferred shares".

Six of the balances should have been classified as "Contributed surplus" since they represented credits resulting from redemption or conversion of shares at less than the amount set up as share capital. The balance was classified as such in only one of the 6 balance sheets concerned. In this case, it was included in a single figure with a balance described in previous statements as "Profit on the sale of company's shares by a subsidiary under employees' stock purchase plan". This figure was described in the 1954 balance sheet merely as "Contributed Surplus" without any elaboration or expansion to indicate the nature of the items included. In the other five cases, the item was set out separately in the shareholder's equity section described as surplus or capital surplus.

The nature of the 4 remaining balances varied. In one case, a footnote to the surplus statement segregated the balance sheet item "Surplus arising from capital stock transactions" into two figures. One represented surplus arising from conversion of preferred shares and the other premium on sale of capital stock. Both are items of contributed surplus but this classification was not recognized

in the balance sheet presentation. Another of these balances represented an appropriation of earnings to a sinking fund to provide for the redemption of preferred shares. However, it was not designated as an item of earned surplus but set out as a separate figure in the shareholders' equity.

In another case, the balance was described as a reserve arising from redemption of preferred shares. It represented the par value of the shares redeemed to date by the trustee from a sinking fund reserve set up by annual appropriations from earnings. It was rather difficult to determine just exactly what the remaining balance represented. The balance sheet concerned showed a total of $50,100 preferred shares redeemed to date. However, the capital surplus resulting from redemption amounted to only $22,879. The shareholders' equity section set out an additional balance "Sinking Fund for Redemption of First Preference Shares – $21,161". The former balance had remained unchanged during the year while the latter was increased by an appropriation from earned surplus. Since the company concerned was incorporated under a provincial statute, it does not have to provide a segregation and designation of earnings similar to that required under the Companies Act (Canada).

Distributable Surplus

None of the 8 items described in 1954 as "Distributable surplus" was classified as an item of "Contributed surplus". However, in one case the grouping of the items within the shareholders' equity section might be interpreted as an indication that this balance had been received by way of contributions from the shareholders. There were only three items in this section, capital stock, distributable surplus, and earnings retained for use in the business. The balances of capital stock and distributable surplus were grouped over a sub-total. Unfortunately, there was no descriptive caption to indicate what this subdivision represented.

One of the balance sheets included this item in the figure designated simply as "Surplus". The statement of surplus supporting this balance set out the amount of the distributable surplus included therein. The deficiencies of presentation in another of the balance sheets concerned have already been pointed out in the discussion concerning example 2. In the remaining 5 balance sheets, the balance was set out as an independent separate figure designated as distributable surplus. Only one of these showed other surplus items which should have been classified as "Contributed Surplus".

Surplus on Consolidation

Eight of the 12 balances representing the excess of book value of a subsidiary over purchase price were shown as elements of corporate surplus. Of these, 6 were set out as separate items within the shareholders' equity section designated as "surplus" or "capital surplus", one was included with other miscellaneous balances and reserves under the heading "Reserves and Surplus", and one was classified as "earned surplus". Except for this last and surprising presentation, no reference was made in any of the balance sheets to classification as to source.

The remaining 4 balances were shown as separate items of the share-

holders' equity and designated by qualification not making use of the word surplus.

Appraisal Increase Credit

The 18 appraisal increase credits shown as part of the shareholders' equity were presented in quite a variety of ways. Of these, only 4 were set out as separate items not designated as surplus or reserve. This is the form of presentation now recommended in Bulletin No. 11. The other 14 were designated as either "surplus" or "capital surplus". Of these, 11 were set out as separate independent figures, one was grouped with the balance "Discount on preferred shares cancelled" under the caption "capital surplus", one was set out with earned surplus under the heading "Surplus" with both balances extended separately. One was included with other items of surplus and reserves under "Reserves and surplus" but the amount of the appraisal credit was extended as a separate figure (see ex. 3).

Contributed Surplus

Four of the 5 balance sheets showing "Contributed surplus" set out the balance as a separate figure independently of the other elements of corporate surplus. In the remaining case, this item was set out together with the balance of earned surplus under the heading "Surplus". This grouping merely indicated the segregation of the total shareholders' equity between capital stock and surplus. As indicated last month, in only one case was the designating description expanded to indicate the nature of item described as "Contributed Surplus". This term was recommended in Bulletin No. 11 as a classification heading, not as terminology to be used to qualify an item of surplus.

Reserves

"Since reserves are segregations of earned surplus, it is desirable that they be shown on financial statements as constituting part of the shareholders equity", states Bulletin No. 9 issued by the C.I.C.A. Committee on Accounting and Auditing Research. Of the 116 balance sheets showing reserves on the liability side, 37 used this recommended form of presentation (see Table 24 of "Financial Reporting in Canada"). However, there was quite a variety in the actual procedures of disclosure. In only 2 cases was the reserve positively classified as an item of earned surplus. The balances of earned surplus and of the reserve were grouped under the descriptive headings "Earnings retained for use in the business" and "Earnings employed in the business". The total thereof was extended as a subtotal of the shareholders' equity. One other balance sheet divided the section headed as "Surplus" into two figures, one described as "Unappropriated" and the other as "Appropriated as . . .". The total surplus was extended as a sub-total of the shareholders' equity. The remaining balance sheets made no reference to the actual source of the balance designated as a reserve or reserves. Reserves were extended as a separate item or items or as a sub-section of the shareholders' equity in 30 cases. This includes 6 instances in which all elements of the shareholders' equity, including reserves, were extended as separate balance sheet items. In the remaining 4 cases, the reserve or reserves were set out as a separate figure or figures or sub-division under the heading "Surplus and reserves".

(To be concluded next month)

BY KENNETH M. PLACE, C.A.

Administrative Accounting

The Cost of Accounting

With the ever-increasing pressure in all phases of industry and commerce attendant upon today's high level of activity and competition, more and more thought is being given to work and procedure simplification. In the past most of the emphasis in this field has been placed on production methods, distribution, material handling and other phases of the physical production of goods and services. Recently, however, there has been an increasing trend toward critical examination and revision of the methods and procedures used to record the results of operations. It might be appropriate to review some of the more simple changes which larger companies have introduced during recent years with the object of cutting down clerical work and costs.

Many factors have combined to make the "keeping of records" an item of major expense in business today. The tremendous increase in volume of goods produced and sold, the demand for up-to-date, accurate information, the complexities of taxation, these and many other factors have all had their impact on the clerical costs of commerce. Not the least of these, however, has been the tradition of accuracy to the last cent which has been cherished in some quarters for so long. This brings us to the first innovation, popularly known as "cents elimination" aimed at simplification.

Briefly, "cents elimination" is just that; this is a little too brief, however, so let us take a further look. An ever-increasing number of companies have come to the conclusion that detailed record keeping of cents is not worthwhile. Accordingly, all internal accounts are kept in dollars only. Where an outside account, such as a bank account or customers' accounts, is involved and cents must be recorded, the balancing entry is posted to a "cents elimination account". All amounts of 50c and up are raised to the next higher dollar, and below 50c they are dropped to the next lower dollar. For example, a debit of $9.51 becomes a debit of $10.00 with a credit of $0.49 to "cents elimination" and a debit of $9.49 becomes a debit of $9.00 with a debit of $0.49 to "cents elimination".

On the surface, this does not seem to be a great time or labour saver, but when you consider the complete application of this procedure, the advantages begin to assume greater magnitude. The recording of two digits is eliminated on all internal entries, the capacity of all posting machines used internally is automatically increased, and infinite time is saved in eliminating the necessity of balancing internal accounts to the last cent. What are the disadvantages? I have observed this system

in use for more than ten years and have yet to come across one. What are the main objections? The principal one is that it offends those who make a fetish of accuracy. What is its actual effect on the accuracy of the records? Very minor; since items under 50c drop down and those over 50c go up, the offsetting effect eliminates any major inaccuracy, and the amount remaining in the "cents elimination account" is always small in relation to the total number of dollars involved.

A second development which follows somewhat along the lines of "cents elimination" is the growing tendency to simplify raw materials and stores accounting records. The most popular method of doing this is the elimination of value records for all items with a net value of less than a given amount. Usually a statistical study is necessary to determine the unit valuation to be used, taking into account the gross value of the inventory concerned, the relationship of the gross value of the issues and receipts at various unit values to the gross inventory value, and the actual number of requisitions and postings involved at representative unit values. Once a decision has been made as to the point where the unit value of the inventory items necessitates accurate records, the system can be put into effect. All dollar accounts for items which do not justify the maintenance of actual records are eliminated. Purchases are charged to costs as made. In some cases, quantity accounts are kept in order to assist in maintaining adequate stocks, but these are usually very elementary, consisting in most cases of bin cards or some similar record showing purchases and issues in quantity only.

A system of this type has a number of advantages. It eliminates the necessity of calculating unit values on a large number of items and cuts down the volume of postings immeasurably because in most plants more than 75% in number of all issues have a unit value of less than $5.00. Balancing of inventories and distributing the cost of stores and supplies issued are greatly simplified.

There are, of course, some undesirable features which must be fully explored. It is easier for misappropriations to occur, since the degree of control is much looser than previously exercised. In making such a simplification, this fact must, of course, be given proper consideration. Another important factor is the effect opposite income tax regulations respecting the valuation of inventories. The problems here, however, can be easily overcome by taking an actual count once a year, in the last month of the fiscal period. This inventory is then valued and taken into the accounts. It may be carried at that value for the ensuing year with any necessary adjustment being made at the end of the year, or it may be reversed immediately, whichever is the more desirable. A similar procedure is also used by many companies to record the value and annual changes in the value of small tools inventories.

Another trend towards simplification occurs in the recording of time worked by hourly-paid employees. Until a few years ago, time-clocks with all their attendant nuisances were a standard fixture in establishments employing hourly-paid workers and in many others too. Recently, however, there has been a decided swing away from their use. On

the surface, there appears to be much in favour of time-clocks as a means of accurately recording the time spent on the job by employees. If you investigate a little further, however, it becomes apparent that the degree of accuracy claimed for them is a myth. In the first place, with the size of today's plants, it is impossible for gatekeepers to recognize every employee, and in many cases nothing could be simpler than for one employee to punch others in. Again, with many plants covering large areas, the simple fact that a man has punched in is no assurance that he is at his place of work. In addition, the necessity of punching in can cause very considerable congestion when shifts are changing and is thus responsible for waste time and needless annoyance to the employees.

You may well ask what is the alternative. In most cases foremen are in an excellent position to keep accurate records for this purpose. In fact, in the majority of plants they are required to do so for purposes of allocating the time worked to the various cost accounts involved. What then could be more natural than to utilize these records that are already available? There are, of course, certain problems to overcome. One of these concerns how to give credit for time taken to get from the point where time-clocks would normally be situated to the actual place of work. This is overcome by calculating the time so spent and adding it to the employee's working time for the day.

What are the advantages of a system such as this? Apart from elimination of the nuisances outlined, the main one is the resultant simplification of payroll procedure. No longer is it necessary to balance daily clock cards with the foreman's time sheets. No longer is the man's pay calculated from the clock record and the clock cards totalled and balanced with the allocation of the charges to the various departments calculated from the individual foreman's records. Thus by cutting out a considerable amount of needless duplication and a tedious, time-consuming balancing operation, as much as 40% of the time required to prepare payrolls can be saved.

There are, of course, other areas in which very worthwhile savings can be achieved, in many cases with only minor changes in existing procedures. One of the more fruitful of these is necessarily in product costing. Here the fetish for accuracy is too often given rein unless proper intelligent supervision is exercised. I well remember one plant where the product cost sheets comprised 60 pages and yet the particular process used was not an involved one. Truthfully in this case it could be said "The finer the tolerance, the greater the cost". Admittedly, there is a great temptation in the field of cost accounting to allocate costs with an ever-increasing degree of refinement. There is always a challenge to a certain type of accountant to charge all items of cost to the particular department concerned with the utmost degree of accuracy. I have seen this phobia carried to the point where a $14 long distance bill was split on a percentage basis to four separate process cost accounts. This, of course, verges on the ridiculous when so many major items of cost, such as plant supervision, certain overhead expenses, etc., are nothing more than approximations based on the judgment and experience of the cost ac-

countant in consultation with the works operating personnel. A critical review of the cost accounts at most plants, bearing in mind that their primary objectives are to give reasonably accurate product costs and to assist management to control these costs by making decisions based on the proper information, will yield many opportunities for the reduction of detail and at the same time achieve worthwhile clerical savings.

Only a very few examples of procedure simplification have been cited in this review. No doubt readers can think of numerous examples within their own experience where similar reductions in effort and cost have been effected with relatively minor changes in accounting procedures. One of the main points to be stressed, however, is the high cost of accuracy to "the last cent". Naturally the accounting system must be designed to give a maximum of accuracy and control, but this "maximum" of accuracy and control must be compatible with the cost of obtaining it. It is a function of a good accountant to exercise judgment in the formulation of procedures and policies to ensure that the results justify the effort involved.

Surely here is one of the challenges in the field of industrial accounting today — to achieve the maximum of accuracy and control with the minimum of clerical cost and time.

BY PETER C. BRIANT, B.COM., C.A.

Current Reading

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MAGAZINE ARTICLES

ACCOUNTING

"ELECTRONIC DATA PROCESSING AND THE ACCOUNTING AND FINANCE FUNCTIONS", by Norman J. Ream. *The Illinois Certified Public Accountant,* Autumn, 1955, pp. 31-39.

Mr. Ream, Director of Systems Planning for the Lockheed Aircraft Corporation, discusses the nature and importance of integrated data processing and briefly reviews the history of electronic data processing machines

He advises that the only practical basis on which to determine whether or not an electronic data processing machine will improve efficiency is to study the data and systems concepts currently available and the procedures currently followed. This course of action is recommended because the machines presently available have been developed to duplicate, by the application of electronic principles, the results now being obtained by other methods.

Will the installation of electronic equipment develop information previously unobtainable? Will the equipment reduce clerical costs through the elimination of paper work and the reduction in clerical staff? These appear to the author to be the two criteria of major importance in evaluating the feasibility of utilizing data processing equipment. He suggests that from a psychological and economic standpoint it is better to conduct initial experiments in an area where increased efficiency in terms of cost reduction can be clearly demonstrated.

To the accountant, the effect on internal control is one important aspect of electronic data processing. Mr. Ream sees the need for a reformulation of our concepts in this area. In support of his contention, he mentions the case of a new machine currently being developed that will eliminate all the documents conventionally used in payroll accounting except for the workers' identification card.

Many of our current post-auditing techniques and pre-processing controls will no longer be applicable. states Mr. Ream. The auditor's real concern will be with seeing that only approved data gets into the system and that adequate controls are established to ensure that unapproved or dishonest data are not accepted.

On the role of the auditor in an electronic era, Mr. Ream continues:

> ". . . It seems that public accountants and internal auditors will, of necessity, devote careful attention to programming techniques in order to ensure themselves that the electronic data processors will produce proper results if fed the proper information. They will almost certainly test by using theoretical transactions and check the machine answers against independently calculated results. They may

likewise test actual transactions against actual answers to ensure that actual results are correct.

"Both public and internal auditors will have to be in a position to review the programming technique developed before the initial operation is commenced in order to satisfy themselves that adequate controls have been provided. . . ."

AUDITING

"THE OBJECT OF A STATUTORY AUDIT", by R. G. W. Wood. *The Chartered Accountant in Australia*, September 20, 1955, pp. 141-143.

Mr. Wood, a Fellow of the Institute of Chartered Accountants in Australia, takes issue with a statement published by the Council of the Institute in which is incorporated a paragraph to the effect that the main purpose of the statutory audit is the expression of opinion by the auditors on the accounts examined by them. In the statement, the detection of "peculations by employees" is held to be "incidental to the main purpose". But the auditor is admonished to satisfy himself that "the internal control, together with his audit procedures, guards against major frauds . . . ."

Mr. Wood argues that the primary emphasis should be placed on the auditor's responsibility for the detection of fraud and error:

> ". . . It seems clear to me that the objects of an audit, even a statutory audit, have not changed since auditors were first appointed by the proprietors of businesses. Their purpose was and is the detection of fraud and the discovery of the truth. The compulsory appointment of auditors under the Companies Act, first included in the Statute in 1900, was designed primarily to protect the shareholders from unscrupulous directors, and to ensure that the auditors were able to reach the shareholders by making their annual report compulsory. I think the manner in which the relevant sections of the Companies Act are framed indicates that no change in the auditor's objects was intended. Their final certificate on a company's balance sheet is merely the logical sequence to their examination of the company's transactions . . ."

Since the wording of section 124 of the Companies Act (Canada) 1934 is substantially the same as the relevant section of the Australian Companies Act, Mr. Wood's contention should raise some interesting questions in the minds of Canadian practitioners. The issue is reported to have given rise to a great deal of provocative thought and discussion in Australia.

BUSINESS

Bank of Montreal Business Review, January 27, 1956.

The almost uninterrupted expansion in the annual volume of capital expenditure on new plant, equipment and housing is stated to be the dynamic force behind Canada's postwar growth, the proportion of the current output of goods and services used for the creation of new physical assets having risen from 11.4% in 1946 to 18.5% in 1955. A continuation of this trend would reportedly result in the proportion of goods and services utilized for investment increasing to more than 25% by 1965. This is con-

sidered to be an unlikely development. For this reason, a decline in the rate of growth of capital expenditure is anticipated.

The increase in capital investment over the last decade has apparently taken place at the expense of external trade which, in 1955, represented only 17.7% of the gross national product in comparison to 21.5% in 1946. There is reason to believe, however, that exports as a whole may assume a more important relative role in the Canadian economy in the years ahead.

A decline in the rate of increase in the Canadian population is expected in the next decade. The decrease in immigration in conjunction with a levelling off in the number of births is expected to offset any continuation of the decline in death rates. Despite this fact, a relative shortage of labor until the early 1960's is forecast.

Concluding on a resounding note, the Review states:

> ". . . there seems to be good reason to believe that growth, with its attendant benefits and problems, will continue to be the hallmark of the Canadian economy . . ."

FINANCE

"Effective Stock Splits," by C. Austin Barker. *The Harvard Business Review,* January-February, 1956, p. 101-106.

Financial writers frequently assert that the original holders of common stock automatically realize a gain from a stock split. To test this hypothesis, Mr. Barker, who, *inter alia,* is manager of financial research with The Cleveland Electric Illuminating Company, studied the activity of the shares of 90 companies that had split their stock in the period from 1951-1953. All the companies are listed on the New York Stock Exchange.

On the basis of his study, Mr. Barker reports that, despite the virtually unanimous opinion to the contrary, stock splits do not automatically bring about a lasting increase in the market prices of stocks which already have a broad ownership base. The significant factor is dividends. In 35 cases in which the stock split was accompanied by a dividend increase, seemingly lasting price gains averaging 15% were effected. On the other hand, no lasting gains were detected in 55 stocks where the split-up was unaccompanied by a dividend increase.

Mr. Barker concludes that if the investor is to realize a genuine gain from a stock split, the most successful course of action is to follow the split-up with a cash dividend increase timed to occur on the next payment date after the split.

EDUCATION

"Undergraduate Curriculum Study." Report of the Task Committee on Standards of Accounting Instruction. *The Accounting Review,* January, 1956, pp. 36-42.

In January, 1954, the Standards Rating Committee of the American Accounting Association recommended that an undergraduate business student majoring in accounting should devote approximately 25% of his time to accounting courses, 25% to other business courses, and 50% to nonbusiness courses. The Committee on Standards of Accounting Instruction now reports on an empirical study of the curricula of 100 schools considered to be representative of all schools offering an accounting major or concentration.

Ten tables are submitted with the report, in the last of which the committee has prepared what it believes to be a curriculum for accounting majors typical of the reporting schools. This table, submitted below, reveals the wide conversance with other areas of business administration commonly required of accounting students in American universities. In interpreting the table it should be noted that '3 hours' represents one term's work only.

Typical Curriculum for Accounting Majors

Accounting Courses	Hours	
Elementary	6	
Intermediate	6	
Advanced	3	
Cost	3	
Auditing	3	
Income tax	3	
Additional auditing or cost	4	
Electives	3	
Total (25%)		31
Other Business Courses:		
Corporation finance	3	
Marketing	3	
Money and banking	3	
Business law	6	
Statistics	3	
Electives in business	13	
Total (25%)		31
Nonbusiness Courses:		
English composition	6	
English literature	6	
Economics	6	
Mathematics	6	
Natural sciences	6	
Social sciences other than Economics	4	
History	3	
Public speaking	2	
Electives and assorted requirements	25	
Total (50%)		64
Total hours		126

MANAGEMENT

"THE PRACTISING ACCOUNTANT'S RELATIONSHIP TO MANAGEMENT ACCOUNTING," by R. G. Leach. *The Accountant*, January 7, 1956, pp. 12-18.

"THE PRODUCTION OF ACCOUNTING INFORMATION FOR MANAGEMENT," by W. W. Fea. *The Accountant*, January 14, 1956, pp. 33-41.

"EFFECTIVE USE OF MANAGEMENT ACCOUNTING," by Ian T. Morrow. *The Accountant*, January 21, 1956, pp. 60-64.

These three papers represent a valuable addition to the growing body of literature on the subject of management accounting. The first is by an accountant in practice; the second by an accountant in industry; the third by an industrial executive.

By its very nature the material defies summarization in the space available. Suffice it to note the sharply divergent viewpoints presented in the first and third papers. Mr. Leach thinks that the accounting practitioner needs no special training to be a successful management consultant. A course of specialized reading and the cultivation of brevity and clarity in report writing appear to him to be sufficient training for the task. Mr. Morrow, on the other hand, considers some executive experience in industry to be a fundamental prerequisite for partners and staffs of professional firms to represent themselves as consultants.

Commenting editorially on this point, *The Accountant* states:

"The alignment of opinion is clearly defined. There is, on the one hand, the view held by practising accountants that they are able in their existing capacity, by

reason of their general training and experience, to undertake any assignment in the field of management accounting that clients may offer. The opposite view, put forward by qualified accountants who have taken up careers in industry, is either that the general practitioner should act as industrial consultant only after having had practical executive experience in industry or that he should refrain altogether from accepting work connected with management accounting . . ."

This important difference in viewpoint is sometimes in evidence among accountants in Canada. With management accounting becoming an increasingly important part of the professional accountant's practice and with many members leaving practice to follow careers in industry, all accountants would be well advised to obtain copies of these articles. Many significant questions remain unanswered, but between them they offer a penetrating insight into the problems involved.

SELECTED READING

Accounting

"Accounting for Research and Development Costs," by National Association of Cost Accountants. *NACA Bulletin*, June, 1955, Sec. 3, pp. 1373-1437.

American Institute of Accountants, *Accounting Research Bulletin No. 45.* Long-term construction type contracts.

Auditing

"Direct Costing — Should it be a Controversial Issue?" by R. Lee Brummet. *The Accounting Review*, July, 1955, pp. 439-443.

"Is Direct Costing the Answer?" by Robert Beyer. *The Journal of Accountancy*, April, 1955, pp. 45-49.

Economics

"What is Ahead for Canada?" by C. M. Short. *Dun's Review and Modern Industry*, September, 1955.

Education

"Training for the Profession," by Donald P. Perry. *The Journal of Accountancy*, November, 1955, pp. 66-71.

Equipment

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[The] *Chartered Accountant in Australia*, c/o the Institute of Chartered Accountants in Australia, Box 3921, by P.O., Sydney, N.S.W.

Dun's Review & Modern Industry, 99 Church St., New York 8, N.Y.

Harvard Business Review, Gallatin House, Soldiers Field, Boston 63, Mass.

Illinois Certified Public Accountant, 208 S. La Salle St., Chicago 4, Ill.

Journal of Accountancy, 270 Madison Ave., New York 16, N.Y.

BY MELVILLE PIERCE, B.A., LL.B.

The Tax Review

WHERE STANDS LIFO NOW?

On December 13 last the Judicial Committee of the Privy Council pronounced its long-awaited judgment in the Anaconda American Brass Ltd. appeal, with the result that the company now finds itself liable to pay more than $700,000 additional tax for 1947. There can be few accountants in this country who are not familiar with the issues involved in that case and with the opposing arguments advanced by the respective sides, and few of them who will not regret that once again, as so often before, the Courts have ruled that accounting principles do not determine annual profit for tax purposes.

The Anaconda company carried on business as a processor of metal, and its policy was to fix its selling prices by reference to the replacement cost of the metal content of the products sold. The company purchased enormous quantities of metal, chiefly copper, each year, and its inventory was turned over three or four times a year. No attempt was made by the company to identify the particular metal used in processing at any time, and although it knew what stock it had on hand at the beginning of each year and what stock it purchased during the year and what stock it had on hand at the end of that year, it had no means of knowing what prices had been paid for the actual metals used during the year or what precise metal was on hand at the end of the year.

Prior to 1947 the price of the metals used by the company had been stable, but in 1947 the price began to rise very rapidly, and the company thereupon decided to employ *Lifo* in valuing its inventory for tax purposes, that method being already in use by the company for valuing its inventory for its own corporate purposes. The effect of adopting this method of valuation for tax purposes in 1947 was to attribute to the company's closing inventory of copper a cost of $1,355,000, whereas under the *Fifo* method (which the Minister employed) the cost attributed to the closing inventory was over $3,000,000. It need hardly be stated here that *Lifo* is merely an assumption as to the flow of inventory costs and does not have, or at least does not purport to have, any relation to the actual physical facts.

When this appeal came on for hearing, the Minister conceded that an assumption would have to be made regarding the metal actually used during 1947, but he insisted that the *Fifo* method more truly reflected the true profit for that year than the *Lifo* method. In valuing stock-in-trade on hand at the beginning and end of an accounting period, the Minister argued, it was the *actual* stock on hand to which regard must be had and its *actual* cost that must be ascertained so far

as possible. It was only when the true cost of the closing inventory could not be ascertained as a fact that an assumption or estimate was permissible, argued the Minister. He then contended that in the case of Anaconda, the *Fifo* method more nearly than the *Lifo* method represented the facts, and cited the following facts in support:

(1) In the last three months of 1947 Anaconda bought more copper than it had on hand at the end of 1947 and all of that metal could therefore not have been processed during 1947.

(2) The adoption of *Lifo* by Anaconda involved the assumption that more than 6 million pounds of copper purchased by the company before 1936 (at 7.5c a pound) was still on hand at the end of 1947 (when the price had risen to more than 21c a pound). Both of these assumptions, the Minister implied, were manifestly absurd.

The Minister, it will be seen, was in fact relying upon the onus provision of the Income War Tax Act, namely that it is for an appellant to establish that an assessment is wrong, not for the Minister to establish that it is right, and he therefore did not seek to show that *Fifo* was the most accurate of all methods for valuing Anaconda's inventory: he merely argued that *Lifo* did not more nearly than *Fifo* reflect the true income of the company in the present case. And that, said their Lordships, was the issue for decision on this appeal.

The company's contention, to put it shortly, was that annual income for tax purposes is determined by accepted accountancy practice unless the Act otherwise provides, and that in the present case the trial Judge had found that *Lifo* was not only an acceptable accountancy method but that it was the most acceptable method and that the method adopted by the Minister was not a proper one.

In the result, the Judicial Committee of the Privy Council rejected the company's argument and accepted the Minister's. They referred to the case of *Whimster* v. *C.I.R.* (1925) 12 T.C. 813 and said that both before and ever since that decision what was to be valued at the beginning and end of the accounting period had for tax purposes been taken to be the *actual* stock *so far as it could be ascertained.* "It is in fact," their Lordships proceeded, "so far as tax law is concerned, a novel and even revolutionary proposal that the physical facts should even where they can wholly or partly be ascertained be disregarded for the purpose of the opening and closing inventory and a theoretical assumption made which is based on a supposed 'flow of cost' and an 'unabsorbed residue of cost'." The *Lifo* method, they added, had travelled far from the conception which had hitherto prevailed in the assessment of income for tax purposes.

In the course of its argument, the Anaconda company had pointed to the capricious and illogical results which the actual user test would produce if applied by identification of parcels of homogeneous material purchased at various prices. This argument made its impression on their Lordships, who conceded that actual user might not always be the final test and intimated, in an *obiter dictum,* that in the circumstances described by the company the average cost method might well be adopt-

ed. "For that method," they said, "like the *Fifo* method, brings into account the cost of every purchase in its order", whereas under *Lifo* the cost of some purchases might never be brought into account at all.

In times of rising prices, the *Lifo* method, they proceeded, resulted in the creation of a hidden reserve which might be of use for the corporate purposes of the company in future years but not, they emphasized, for income tax purposes. "The Income Tax Act is not in the year 1947 concerned with the years 1948 or 1949; by that time the company may have gone out of existence and its assets been distributed."

It is clear from their Lordships' judgment that in the computation of annual business profits for income tax purposes regard must be had to the ascertainable facts, and that an accounting assumption which contravenes the true facts may not be substituted for the truth except, perhaps, where a computation based on the true facts would lead to capricious and illogical results. Thus, the Judicial Committee intimates, in valuing an inventory of homogeneous material the average cost method might properly be adopted in preference to the actual user test, which in some circumstances would lead to capricious and illogical results.

The case is important for clarifying some basic principles of income tax law. First it makes it clear that for income tax purposes periodic business profits must be computed more stringently than accounting practices would require. In particular, it indicates that for tax purposes each taxation year must be looked at in isolation from prior and subsequent years. Also, as was perhaps to be expected, it indicates the inveterate preference of the Courts for proof based upon external and verifiable facts rather than upon assumptions and mental conceptions.

The case does not rule out *Lifo* for all purposes. It is likely that *Lifo* will be a permissible method of inventory valuation for tax purposes if it conforms to the facts, i.e. to actual user, but even then it might be prohibited if the actual user test led to capricious and illogical results.

BY J. E. SMYTH, C.A.

Students Department

Associate Professor, Queen's University

A TALE OF TWO STUDENTS

James and John were both intelligent and hard-working, they prepared their accounting exercises with meticulous care and demonstrated in their answers that they paid attention to their instruction. Before the accounting examination, the teacher told all his students that if they could not get a part of a question to balance, they should not spend a great deal of time trying to locate the error; too much time might be wasted when they could be garnering marks on other questions.

Then came the EXAMINATION. James omitted cash discounts from his income statement and could not balance; he made a note that there was a mistake somewhere and carried on with other problems. He lost only two marks on the question and completed the paper with a mark of over 90. John, on the other hand, was constitutionally incapable of leaving a question unbalanced. He made a slip of $1,000 in his income statement; recopied the statement, repeating the error; crossed out so many figures that he had to use other money columns to show his new figures. He still could not balance and finally only had time left to do a small part of the remaining thirty mark question. As a result he did not receive first class honours in spite of his otherwise excellent record.

(This story illustrates the advantage of a candidate realising that few of those competing with him will answer any question perfectly and why he should attempt to answer all the questions without becoming downhearted because he is unable to produce a perfect solution for each).

PROBLEM 1

Final Examination, October 1954

Accounting III, Question 5 (30 marks)

The following financial statements of the B Co. Ltd., a public company with over 1,000 shareholders, for the year ended 30 June 1954 have been drafted by the accountant. You have completed your audit and are satisfied as to the amounts shown therein.

The directors have asked you to draw up the financial statements they should submit to the shareholders and for general publication. They want the statements to conform to the requirements of the Companies Act, 1934 (Canada) and good accounting practice. They ask that all information which a shareholder needs to assess the value of his shares be included and that the presentation be as simple as is reasonable within such limits.

Fixed assets have been recorded at cost.

Patents and goodwill have been recorded at cost less, in the case of

patents, amounts written off as a charge against the cost of goods manufactured. The charge for the current year was 1/17 of the cost of the patents.

The par value of the Government of Canada bonds is $100,000. The bonds were quoted at 30 June 1954, at 91⅝ - 91⅞.

The investment in the subsidiary represents the par value of 80% of the issued common shares of the subsidiary subscribed when the company was formed in 1950. The profits of the subsidiary for the year ended 31 May 1954 amounted to $248,000 and the earned surplus as at the date amounted to $684,900.

Depreciation has been recorded in the books at the maximum rates allowed for tax purposes. The directors inform you that, had depreciation been calculated on the same basis as in the previous year, they would have recorded depreciation as follows:

Buildings	$ 17,000
Machinery	57,680
Equipment	8,310
Tools	3,700
Trucks	7,120
Autos	2,467

Had capital allowances been claimed at the above amounts, taxes on income would have been increased by $18,828.

B CO. LTD.
Balance Sheet
as at 30th June 1954

ASSETS

Cash on hand			$ 4,785
Cash in bank			142,640
Accounts receivable — trade		$217,200	
— subsidiary		81,200	
— employees		920	
Notes receivable	$87,000		
Less — notes receivable discounted	14,500	72,500	
		$371,820	
Less — allowance for bad debts		14,800	357,020
Inventories—raw materials—at average cost			74,900
—work-in-process—at average cost			18,560
—finished goods—at lower of cost or market			187,800
Prepaid insurance			3,164
Utility deposits			780
Prepaid taxes			11,450
Unemployment insurance stamps			37
Accrued interest receivable on Government of of Canada bonds			750
Advances to subsidiary			64,950

Investment in shares of subsidiary at cost		200,000	
Marketable securities — 3% Government of Canada bonds — interest payable April 1, October 1 at cost		92,500	$1,159,336
Land		$ 240,000	
Buildings		850,000	
Machinery		721,000	
Equipment		138,500	
Tools		14,800	
Trucks		35,600	
Autos		14,800	
		$2,014,700	
Less—depreciation:			
Buildings	$295,410		
Machinery	316,520		
Equipment	54,920		
Tools	7,280		
Trucks	21,460		
Autos	6,940	702,530	
		1,312,170	
Patents		14,800	
Goodwill		120,000	1,446,970
			$2,606,306

LIABILITIES AND CAPITAL

Liabilities		
Accounts payable—trade	$ 312,900	
—subsidiary	33,300	
—machinery purchased	14,000	
Accrued wages payable	9,840	
Accrued interest payable	4,125	
Taxes on income	34,250	
Bonds payable—5½% first mortgage bonds, interest due 1st May, 1st Nov. — $25,000 payable on principal each November	425,000	$ 833,415
Reserves		
General contingencies	$ 100,000	
Future decline in inventory values	37,800	
Asset replacement	93,000	230,800
Capital		
2,500–6% preferred cumulative shares redeemable at 104 authorized and issued	$ 250,000	
50,000 no par value common shares authorized and issued	700,000	
Premium on issue of preferred shares	5,000	
Surplus	587,091	1,542,091
		$2,606,306

B CO. LTD.
SURPLUS ACCOUNT
for the year ended 30 June 1954

Balance as at 1st July 1953		$ 541,868
Profit for the year		106,390
Profit on disposal of machinery		4,620
Correction of entry 30 June 1953 re prepaid insurance		92
		652,970
Less—dividends	$ 65,000	
—loss on sale of trucks	812	
—loss on sale of autos	67	65,879
Balance as at 30 June 1954		$ 587,091

B CO. LTD.
STATEMENT OF TRADING AND PROFIT AND LOSS
for the year ended 30 June 1954

Sales		$2,606,590	
Less—returns	$ 34,850		
—discounts	12,340	47,190	$2,559,400
Cost of goods sold			
Inventory of finished goods—1st July 1953		282,500	
Cost of goods manufactured		1,899,750	
		2,182,250	
Inventory as at 30 June 1954		251,800	1,930,450
Gross profit			628,950
Reduction of inventory of finished goods to market			64,000
			564,950
Selling expenses—			
Sales manager's salary	$ 20,000		
Salesmen's salaries	30,000		
" commissions	68,000		
" expenses	41,200		
Advertising	152,630		
Sundry	9,420	$ 321,250	
Administrative expenses			
Directors' fees	$ 6,000		
Executive salaries	54,000		
Other salaries	50,145		
Heat, light and water	9,420		
Depreciation on office building	6,000		
" " " equipment	8,450		
" " autos	2,100		
Bond interest	24,875		
Taxes on income	62,110		
Sundry	5,210	228,310	549,560

	15,390
Add—bond interest	3,000
—dividends	24,000
—transferred from inventory reserve—see above	64,000
Net profit for the year	$ 106,390

B CO. LTD.
STATEMENT OF COST OF GOODS MANUFACTURED
for the year ended 30 June 1954

Work-in-process as at 1st July 1953				$ 16,480
Raw materials used in production				
Inventory as at 1st July 1953			$ 86,200	
Purchases		$1,260,685		
Less—returns	$ 78,460			
—discounts	9,285	87,745	1,172,940	
			1,259,140	
Inventory as at 30th June 1954			74,900	
			1,184,240	
Direct labour			222,500	
Indirect labour			107,255	
Supervision			37,820	
Depreciation—building		21,750		
—machinery		81,000		
—equipment		8,250		
—tools		2,500		
—trucks		4,250	117,750	
Heat, power and light			48,290	
Supplies			69,270	
Municipal taxes			38,420	
Repairs—building			12,150	
—machinery			28,840	
—equipment			4,020	
Trucks			2,010	
Amortization of patents			1,000	
Sundry			28,265	1,901,830
				1,918,310
Work-in-process as at 30th June 1954				18,560
Cost of goods manufactured				$1,899,750

Required:

The financial statements that you would recommend be submitted to the shareholders in the form you would recommend.

A SOLUTION

B CO. LTD.

Statement of Profit and Loss
for the year ended 30 June 1954

Sales revenue			$2,559,400
Deduct cost of goods sold (*note 1*)			1,994,450
Gross trading margin			564,950
Selling expenses		$ 321,250	
Administrative expenses			
Executive remuneration	$ 54,000		
Directors' fees	6,000		
Other salaries and expenses (*note 1*)	81,233		
		141,233	
Bond interest		24,875	
			487,358
			77,592
Subsidiary revenue			
Dividend from subsidiary company (*note 2*)		24,000	
Bond interest earned		3,000	
			27,000
Profit for year, before non-recurring items and income taxes			104,592
Profit on disposal of machinery and equipment			3,741
Profit for year, before income tax			108,333
Provision for income tax			62,110
Profit for year (note 3)			$ 46,223

Note 1: These items include depreciation on buildings and equipment in the amount of $134,300, and amortization of patents, $1,000.

Note 2: The company's share of the profits of the subsidiary for the year ended 31 May, 1954, amounted to $198,400.

Note 3: The depreciation recorded in the accounts, totalling $134,300, is the maximum allowed for tax purposes and was $38,023 in excess of normal depreciation. Had the normal depreciation been included in the accounts, the taxes on income would have been increased by $18,828, and the profit for the year would have been shown as $65,418.

B CO. LTD.

Statement of Unappropriated Earned Surplus
for the year ended 30 June 1954

Balance as at 30 June 1953		$ 541,868
Add Net profit for the year		46,223
Transferred from inventory reserve		64,000
		652,091
Deduct dividends paid		
Preferred	15,000	
Common	50,000	
		65,000
Balance as at 30 June 1954		$ 587,091

B CO. LTD.
BALANCE AS AT 30 JUNE, 1954
ASSETS

Current assets			
Cash on hand and in bank		$ 147,425	
Government of Canada bonds, at cost (market value, $91,625)	$ 92,500		
Add accrued interest	750		
		93,250	
Accounts receivable	218,120		
Notes receivable	72,500		
	290,620		
Less allowance for doubtful accounts	14,800		
		275,820	
Due from subsidiary company		47,900	
Inventories:			
Raw materials, at average cost	74,900		
Work in process, at average cost	18,560		
Finished goods, at the lower of cost and market	187,800		
		281,260	
Prepaid expenses (taxes, insurance, utility deposits, etc.)		15,431	
Total current assets			$ 861,086
Investment in and advances to subsidiary company			
Shares, at cost (*note 4*)		200,000	
Advances		64,950	
			264,950

Fixed assets

	Cost	Accumulated depreciation	Net	
Land	$ 240,000		240,000	
Buildings	850,000	295,410	554,590	
Machinery and equipment	924,700	407,120	517,580	
	$2,014,700	$702,530		
Total fixed assets				1,312,170

Other assets		
Patents, at cost less amount written off	14,800	
Goodwill, at cost	120,000	
		134,800
		$2,573,006

Note 4: Book value of investment in subsidiary as at 31 May, 1954: $747,920

LIABILITIES AND SHAREHOLDERS EQUITY

Current liabilities			
Accounts payable (trade)		$ 326,900	
Accrued expenses (wages and interest)		13,965	
Taxes on income		34,250	
Instalment on bonds payable, due 1 Nov 1954		25,000	
Total current liabilities			$ 400,115
Long term liability			
5½% first mortgage bonds, interest payable May 1 and Nov. 1, with $25,000 principal payable on Nov. 1 each year		500,000	
Less redeemed to date (instalment due Nov. 1, 1954 included in current liabilities above)		100,000	
			400,000
Total liabilities			800,115
Shareholders equity			
Capital stock:			
Preferred — Authorized and issued, 2,500 6% preferred cumulative shares of $100 par value each, redeemable at 104		250,000	
Common — Authorized and issued, 50,000 no par value common shares		700,000	
Premium on preferred shares		5,000	
Paid-in capital		955,000	
Earned surplus:			
Appropriated —			
General contingencies	$ 100,000		
Future decline in inventory values	37,800		
Asset replacement	93,000		
	230,800		
Unappropriated — per statement attached	587,091		
		817,891	
Total shareholders equity			1,772,891
			$2,573,006

Contingent liability: notes receivable under discount, $14,500.

Examiner's Comments

Some students spent time on a manufacturing statement, which was not required.

NEWS OF OUR MEMBERS

Alberta

Christenson, Simonton & Co., Chartered Accountants, announce the removal of their offices to the Anglo American Bldg., 330-9 Ave. W., Calgary.

British Columbia

Bailey, Monteith, Holms & Co., Chartered Accountants, Scollard Bldg., Victoria, announce the admission to partnership of James A. Wood, B.Com., C.A.

Rutherford, Bazett & Co., Chartered Accountants, announce that they have assumed the practice of the late George Griffiths. They further announce that S. John Ladyman, C.A. has been admitted into partnership of the Vernon practice and that henceforth this practice will be carried on under the firm name of Rutherford, Bazett, Ladyman & Co., Chartered Accountants, at 2908 Barnard Ave., Vernon.

Rickard, Crawford & Co., Chartered Accountants, 850 W Hastings St., Vancouver, announce the opening of an office for the practice of their profession at 817 Granville St., Vancouver, and the opening of a South Burnaby office at 3603 Imperial St., South Burnaby. The resident partner of the latter office is David A. Moulding, C.A.

The appointment of Alexander Campbell, C.A. as vice-president, Finance, Western Canada Breweries has been announced by W. Ross MacKenzie, president. Mr. Campbell retains his position as treasurer which he has held for the past five years.

Ontario

Riddell, Stead, Graham & Hutchison, Chartered Accountants, and A. W. Quayle & Co., Chartered Accountants, announce the merging of their practices in Ottawa. The combined practices will be carried on in the name of Riddell, Stead, Graham & Hutchison with offices at 63 Sparks St., the resident partners being A. W Quayle, C.A., R. B. Humphreys, C.A. and J. A. Cunliffe, C.A.

Dick, Bond, Hetherington & O'Loane, Chartered Accountants, announce the admission to partnership of J. W. Scott, B.A., C.A.

W. N. Smith, C.A., has been named city treasurer of Kingston, Ontario.

The appointment of V. W. Scully, F.C.A. as vice-president and general manager of The Steel Co. of Canada Ltd. has been announced by H. G. Hilton, president.

B. B. Puddy, C.A. has been appointed a director of Stevenson & Kellogg Ltd., Montreal.

J. A. Cuddie, C.A has been appointed treasurer of Canadian Pittsburgh Piping Ltd., Hamilton.

D. M. Murton, C.A., has been appointed assistant-secretary of Bawden Industries Ltd., Toronto.

J. I. Battler, C.A. has been appointed Comptroller of Preston Woodworking Machinery Company Ltd., Preston, Ont.

Quebec

Elected to the Board of Directors of Daly & Morin Ltd. at the annual meeting was Malcolm Blakely, C.A.

The appointment of E. L. Hamilton, C.A. as a vice-president of Canadian Industries Limited has been announced by H. Greville Smith, president. Mr. Campbell is treasurer of the company and has been a director since March 1955.

INSTITUTE NOTES

ONTARIO

73rd Anniversary Dinner — Nearly 700 guests, members and students attended the 73rd Anniversary Dinner on Friday, March 9th, 1956, at the Royal York Hotel. Mr. H. G. Norman, C.M.G., F.C.A., Consul General of Canada in New York, spoke on the early history of chartered accountancy in Canada and indicated the debt the present members owe to those who had laid such excellent foundations for the profession.

Members by Affiliation — The following applicants were admitted to membership by affiliation on March 9th, 1956: Frederick Raymond Weatherley (Eng. '46), Duncan Valentine McPherson (Scot. '52), Vernon Ralph Wood (Alta.'55), John Norman McLeod (Scot. '38, Nfld. '53).

By-law 2A and Affiliations — J. O. Dean of Toronto, a member of the Transvaal Society of Accountants in South Africa, was admitted to membership by the Council on January 7 under the authority of by-law 2A. At the same time the following applicants were admitted to membership by affiliation: Richard M. Wingfield (Que. '52), and Archibald K. Morgan (Eng. '30).

Regulations Governing Municipal Auditors — The Ontario Gazette issue of March 3rd included new regulations for Provincial Auditors. The regulations were made under the Municipal Affairs Act and provide for four classes of licenses. All Municipal Auditors will receive a copy of the regulations in the near future but anyone can obtain one from the Department of Municipal Affairs.

Committee on Accounts and Audits — As a result of the work of the Committee on Accounts and Audits of Municipal and certain other organizations, a recommendation was made in January to the Minister of Public Welfare concerning the accounting and auditing regulations under the Charitable Institutions Act. The Committee was seeking to improve the requirements for accounts and to provide for an Auditor's Report which would follow as closely as possible the form recommended by the C.I.C.A. The Committee is now studying the requirements for accounts and audits under the Municipal Affairs Act and would welcome the comments from members who may have suggestions in this field.

Annual Conference — At the first annual conference of the Institute to be held in Kingston on Monday and Tuesday, June 18 and 19, the guest speaker at the opening day dinner will be Dr. W. A. Mackintosh, Principal and Vice Chancellor of Queen's University.

Lecture Hall — The Lecture Hall of the C.A. Building with accommodation for 200 people and a public address system is available for outside groups at a rental of $25.00 for the morning or afternoon or $50.00 for a full day. All enquiries should be made to the Registrar.

C. A. Act — A Bill to reconstitute the Institute of Chartered Accountants of Ontario was given first reading in the Ontario Legislature on Tuesday, March 6, 1956. The Bill includes the recommendations of the Institute's Council necessary to bring the present act up to date. It includes a provision that it does not become effective until a by-law is passed by the members to reconstitute the Institute. At present the Council is working on a revision of the by-laws and when these are completed and providing the Bill is enacted, they will both be presented to a special meeting of members for consideration.

***Course of Instruction Rules* 1955-56** — The Council is continuing to enforce strictly the rules for submitting lessons because it believes that this is the best way of helping the students to make satisfactory progress. The rules require students to complete the courses in which they are enrolled or re-enrolled by Saturday, September 1, 1956, in order to be eligible for examinations dependent on the courses or to proceed in the next year of the course. The rules are set out in detail in the June 1955 Information Booklet and are also printed on a copy of the enrolment form which each student receives after his application for enrolment has been accepted. Last year some 20 students were prevented from continuing in the next year of the course and 17 from writing the 1955 examinations because their courses were not satisfactorily completed by the required date. Practising members recently received progress reports for their students showing the number of lessons accepted by Queen's as of the due date for lesson number 5. They were asked to inform their students of this information and to make sure of their understanding of the regulations.

ONTARIO STUDENTS' ASSOCIATION

"Careers Night" — A "standing room only" audience of 170 Toronto students and recent graduates, enjoyed the March 13th Careers Night. A panel of five speakers under the chairmanship of Clem L. King, F.C.A. outlined career opportunities in various fields and gave freely of their time in answering questions afterwards. This type of meeting has proved so successful it is bound to become an annual affair.

April Meeting — Date is set for April 10th in the C.A. Building, time 8:00 p.m. Speaker and topic will be notified to students by letter.

Nominations — Excellent opportunities for service are yours as a member of the Students' Association Council. The experience is usually a stimulating one and with the organization as active as it is now, you can see results for what time and effort you are asked to give. If you enjoy working with a team for the good of others, in this case your fellow students, answer the call for nominations which will reach you by mail in the next day or two.

Blazer Crests — Inflation has finally caught up with our blazer crests and it is necessary to increase the price to students from $6.50 to $7.00 when present supplies are exhausted. The price to members of the Ontario Institute who are not members of the Students Association will now be raised from $7.50 to $8.00.

NOVA SCOTIA

The convocation dinner and dance of the Nova Scotia Institute was held at the Lord Nelson Hotel, Halifax, on February 27, 1956. About 130 were present including wives of members and students. Presentation of diplomas was made by Gerald Martin, president of the C.I.C.A. The special speaker for the occasion was Dr. J. B. Hardie, Professor of Hebrew and Old Testament History at Pine Hill Divinity College.

CLASSIFIED ADVERTISEMENTS

Rates: ***Positions wanted, $7.00 per column inch; Positions offered, $10.00 per column inch; Open rate $17.00 per column inch.***
All replies to box numbers should be sent to The Canadian Chartered Accountant, 69 Bloor Street East, Toronto 5, Ontario.

Closing date is 14th of preceding month

POSITION WANTED. 1954 graduate wishes to associate with public accountant in Toronto with partnership or succession possibilities. Box 553.

POSITION WANTED: Ambitious chartered accountant, age 30, presently in public practice, desires position with practising chartered accountant in the Toronto area with a view to partnership or succession of practice. Box 556.

STUDENTS WANTED: Junior student and intermediate student required for chartered accountant's office in Montreal. Give particulars concerning education, qualifications, experience and references. Salary accordingly. Box 558.

CHARTERED ACCOUNTANT: Required for expanding practice. Opportunity for partnership available. Apply to K. Douglas MacLennan & Company, 744 Ouelette Avenue, Windsor, Ontario.

CHARTERED ACCOUNTANTS AND STUDENTS: Positions available with Toronto firm of chartered accountants (Jewish). Excellent opportunities for advancement and participation. Box 554.

WANTED: Chartered accountant or senior student by a firm of chartered accountants in Toronto, Ontario. Good salary, diversified experience and partnership available. Box 552.

PRACTICE FOR SALE: In rapidly expanding town between Toronto and Hamilton. Box 559.

ARE YOU MERGER MINDED? Exceptional opportunity available in Toronto for a small firm or sole practitioner to join with same. For particulars write Box 555.

EXPERIENCED BOOKKEEPER: With full office set up at home (Toronto) desires work taking accounts to trial balance. Box 557.

BUSINESS ADMINISTRATOR: Recent graduate C.A., C.P.A. or B.Com., required for newly formed science college. College background would be helpful but not imperative. Application with references and full particulars as to age, experience, salary expected and availability should be made to Macdonald & Healey C.A.'s, 504 Bartlet Building, Windsor, Ontario.

INTERMEDIATE STUDENT REQUIRED: My practice will give ample opportunity for experience and initiative to a senior student in third or fourth year seeking more varied work. He will be required to assist in the supervision of two junior students under direction of myself and my qualified assistant (1955). The opening developes as my senior qualified assistant (1954) is leaving for industry. R. H. B. Hector, C.A., 17 Queen St. East, Toronto. EM 4-4725.

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